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SUPREME COURT, U.S.

# TRANSCRIPT OF RECORD

## SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

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No. 199

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

GLENSHAW GLASS COMPANY AND WILLIAM GOLDMAN THEATRES, INC.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 8, 1954

CERTIORARI GRANTED OCTOBER 14, 1954

# SUPREME COURT OF THE UNITED STATES

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1 The Tax Court of the United States

Docket No. 30821

GLENSHAW GLASS COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

DOCKET ENTRIES

1950

Oct. 2. Petition received and filed. Taxpayer notified. Fee paid.

Oct. 2. Notice of appearance of Max Swiren, Ben W. Heineman, Joseph D. Block and Sidney B. Gambill as counsel filed.

Oct. 3. Copy of petition served on General Counsel.

Dec. 1. Answer filed by General Counsel.

Dec. 1. Request for hearing in Pittsburgh, Pa. filed by General Counsel.

Dec. 11. Notice issued placing proceeding on Pittsburgh calendar. Service of answer and request made.

1951

Sep. 4. Hearing set December 3, 1951, Pittsburgh.

Dec. 6. Hearing had before Judge Arundell on the merits. Amendment to petition, amended answer to petition, reply to amended answer, motion to withdraw as counsel, Max Swiren—granted—filed. Stipulation of facts filed. Briefs, Feb. 4, 1952. Replies, March 6, 1952.

Dec. 21. Transcript of hearing 12/6/51 filed.

2 1952

Feb. 1. Motion for extension of time to Feb. 18, 1952 to file brief, filed by respondent. Granted 2/1/52.

Feb. 1. Brief filed by taxpayer.

Feb. 18. Motion for extension to Feb. 28, 1952 to file brief filed by General Counsel. Granted 2/20/52.

Feb. 28. Brief filed by General Counsel.

Feb. 29. Taxpayer's brief served on General Counsel.

Mar. 28. Motion for extension to April 10, 1952 to file reply brief filed by taxpayer. Granted 3/31/52.

Mar. 31. Reply brief filed by General Counsel.

Apr. 9. Reply brief filed by taxpayer. Copy served.

Apr. 16. Motion to strike portion of respondent's reply brief, and, in the alternative, for leave to file memorandum in answer thereto filed by taxpayer. Memorandum lodged. 8/12/52 denied. Copy served 8/12/52.

1952

Aug. 13. Findings of fact and opinion rendered. Arundel J. Decision will be entered under Rule 50. Copy served.

Dec. 1. Agreed computation for entry of decision filed.

Dec. 3. Decision entered, Van Fossan J. Div. 9.

1953

Mar. 2. Petition for review by U. S. Court of Appeals, Third Circuit, filed by General Counsel.

Mar. 2. Notice of filing petition for review sent to Sidney B. Gambill, Esq. filed.

Mar. 5. Proof of service of notice of filing petition for review filed.

Apr. 6. Motion for extension of time to May 29, 1953 to
3 prepare and transmit the record filed by General Counsel.

Apr. 7. Order enlarging time to May 29, 1953 to prepare and transmit and deliver the record entered.

May 15. Statement Re Diminution of record filed by General Counsel with statement of service thereon.

May 15. Motion to retain exhibits until ten days prior to hearing in Circuit Court filed by General Counsel.

May 19. Order that the Clerk of this Court retain the original exhibits 10 days prior to the hearing in the U. S. Court of Appeals, entered.

STIPULATION OF FACTS

It is hereby stipulated with respect to the above-entitled proceeding that the following statements may be accepted as facts and that this stipulation shall be without prejudice to the right of either party to object to the relevancy or materiality of any fact set forth herein and to introduce other and further evidence at the trial of this case not inconsistent with the facts herein stipulated:

1. The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the fiscal year here involved the petitioner's Federal income tax return was filed with the Col-
4 lector of Internal Revenue for the 23rd Collection District of Pennsylvania. A copy thereof will be offered in evidence at the hearing without formal proof of authenticity.

2. For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license

agreements were without restriction as to the type of glass containers that could be manufactured by the petitioner.

3. Early in 1923, Hartford-Empire Company, representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free Howard license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles, and certain other items.

4. From 1923 until 1931 petitioner used and operated only glass-feeding machines under license agreements with Hartford providing for payment of royalties upon all production from such feeders and limiting the type of containers which petitioner could produce therewith. Each license agreement contained a provision
5 permitting its termination by petitioner upon the payment of a prescribed lump sum minimum royalty. Pursuant to the license agreements, royalties were paid by petitioner to Hartford from 1923 through the fiscal year ended September 30, 1931.

5. The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July, 1931, and a five-year contract for the sale of its fruit jar output was extended with the Samuel Mallinger Company in September of that year. In December, 1932, the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

6. In 1931, and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During 1931, and in the forepart of 1932, Haub developed and built in the petitioner's plant a new feeder, known as the Shawkee feeder. The petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. In March, and May, 1932, the peti-
6 tioner installed two Shawkee feeders, replacing two Howard (Hartford licensed) feeders. In April, and May, 1933, two

additional Shawkee feeders were installed in the petitioner's plant. On the date of the permanent injunction, October 19, 1934 (referred to hereinafter in paragraph 8), the petitioner had seven royalty-free Shawkee feeders in operation and was manufacturing 65 percent of its total production on these machines. It had by then dismantled five Howard (Hartford licensed) feeders. Upon the issuance of the permanent injunction, herein referred to, the royalty-free Shawkee feeders were dismantled. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Howard feeders and pay royalties, which will be hereinafter mentioned. The Shawkee feeder proved to be an efficient, workable feeder, equal to those covered by the Hartford licenses. Were it not for the injunction of 1934, the petitioner would have continued to install royalty-free Shawkee feeders to replace the Howard and Hartford feeders.

7. On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Company* v. *Shawkee Manufacturing Company, et al.*, Docket No. 2791. A copy of Hartford's Bill of Complaint will be offered in evidence at the hearing without formal proof of authenticity. Shawkee Manufacturing Company, the petitioner, and others filed a timely answer to the Hartford Bill of Complaint. A copy of this answer will be offered in evidence at the hearing without formal proof of authenticity. On the basis of an earlier decision in *Hartford-Empire Company* v. *Hazel-Atlas Glass Company*, 59 F. (2d) 399 (C.A. 3rd), the Complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner. A copy of the decree and order for preliminary injunction will be offered in evidence at the hearing without formal proof authenticity.

7

8. Relying upon its earlier decision in the *Hazel-Atlas* case, supra, the Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction. The decision of the Third Circuit affirming this order is reported at 68 F. (2d) 726, which is incorporated herein by reference. Pursuant to the mandate of the Court of Appeals for the Third Circuit, following the affirmance of the order for the preliminary injunction, hereinbefore mentioned, the United States District Court for the Western District of Pennsylvania entered an order for a permanent injunction on October 19, 1934. A copy of such interlocutory decree of the United States District Court will be offered in evidence at the hearing without formal proof of authenticity.

The accounting directed by the interlocutory decree referred to in the preceding paragraph was finally concluded by a settlement of the parties in 1939, whereby the petitioner paid Hartford the sum of $11,167.85. A final decree was thereupon entered.

10. In 1939, the United States instituted a Civil Action No. 4426 in the United States District Court for the Northern District of Ohio, Western Division, in which Hartford-Empire was ultimately held to have violated the Federal anti-trust laws. On August 25, 192, the District Court handed down an opinion which is reported as *United States* v. *Hartford-Empire Company, et al.*, 6 F. Supp. 541. Upon appeal, the United States Supreme Court on January 8, 1945 affirmed the judgment insofar as the District Court had found and held that Hartford-Empire had violated the anti-trust laws. This opinion is reported as *Hartford-Empire Company, et al.* v. *United States*, 323 U. S. 386. Upon petition for clarification of the Supreme Court's opinion that Court handed down a second opinion on April 2, 1945 which is reported as *Hartford-Empire Company, et al.* v. *United States*, 324 U. S. 570. These opinions of the District and Supreme Courts are incorporated herein by reference.

11. After December 1940, the petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision was a result of information disclosed in anti-trust proceedings prosecuted against Hartford by the United States. Hartford-Empire thereupon filed an action for royalties against petitioner in 1941 in which petitioner interposed a counter-claim which is described more fully n paragraph 12 of this stipulation. In addition, based upon documents uncovered in the Government anti-trust action, petitioner in 1941 instituted proceedings to reopen and set aside the decree in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, 68 F. (2d) 726. These latter proceedings are described more fully in paragraphs 13-15 of this stipulation.

12. The action for recovery of royalties under the Hartford and Howard feeder licenses brought by Hartford-Empire against petitioner in 1941 was entitled *Hartford-Empire Company* v. *Glenshaw Glass Co.* Civil Action No. 1650, in the United States District Court for the Western District of Pennsylvania. Following the disclosures made in the Government's anti-trust case, the petitioner filed an answer and counter-claim in such action asking for a return of certain royalties and damages for violation of the anti-trust laws. A copy of such answer and counterclaim will be offered in evidence at the hearing without formal proof of authenticity. Hartford's motion to strike the petitioner's counterclaim on the ground it stated no cause of action was denied by District

Judge Schoonmaker in 1942. The opinion is reported at 47 F. Supp. 711. Such opinion is incorporated herein by reference. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

13. In the proceedings instituted to reopen the decree in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, supra, petitioner charged that the judgment entered in 1932 in *Hartford-Empire Company* v. *Hazel-Atlas Glass Company*, supra, had been secured through fraud, and that the Hazel-Atlas judgment
10 was fraudulently employed to secure the permanent injunction against the petitioner in 1934 in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, supra. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing and the applications to vacate the judgments were denied by the Court of Appeals for the Third Circuit, by a divided Court. The opinion of the Court of Appeals is reported at 137 F. (2d) 764, and this opinion is incorporated herein by reference. On appeal, the Supreme Court of the United States, in 1944, ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the grounds of fraud. These opinions are reported at 322 U. S. 238, and 322 U. S. 271, and are incorporated herein by reference. The Supreme Court ordered that the fraudulently obtained judgment entered against the petitioner in 1934 be annulled and set aside, that Hartford's Bill of Complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

14. Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Case No. 2791, seeking compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount based upon the fraud findings of the Supreme Court. The District Court denied all of the petitioner's
11 claims for damages except the claim for restitution of the $11,167.85 paid by the petitioner to Hartford in 1939, in settlement of the accounting order above referred to. The opinion of the District Court is reported at 67 F. Supp. 26 (D.C.W.D. Pa. 1946), which is incorporated herein by reference. Both Hartford and the petitioner appealed to the United States Court of Appeals for the Third Circuit from the judgment entered by the District Court. A copy of the brief filed with the Court of Appeals by petitioner will be offered in evidence at the hearing without formal proof of authenticity. This appeal culminated in the opinion of the Court of Appeals for the Third Circuit filed August 14, 1947,

and reported at 163 F. (2d) 474. This opinion is incorporated herein by reference.

15. Both Hartford and the petitioner filed petitions for rehearing with the Court of Appeals, and Hartford filed "comments" upon the petitioner's petition for rehearing. Copies of the two petitions for rehearing and of the comments will be offered in evidence without formal proof of authenticity. The petitions for rehearing were denied by the Court of Appeals for the Third Circuit on October 1, 1947.

16. In December, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court, a settlement was concluded between the petitioner and Hartford of all litigation then pending between them. This settlement was evidenced by a settlement agreement dated December 15, 1947, executed by the petitioner and Hartford and two mutual releases dated December 19, 1947, and December 22, 1947.

12 Pursuant to the settlement agreement, Hartford paid the petitioner $813,358.24 on December 23, 1947. Concurrently therewith Hartford paid the petitioner the sum of $48,000 which the petitioner immediately returned to Hartford in consideration of the license for Hartford and Howard feeders, dated December 22, 1947. Copies of the settlement documents will be offered in evidence without formal proof of authenticity.

17. In the fiscal year involved in this proceeding, ended September 30, 1948, the petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

SIDNEY B. GAMBILL,
*Counsel for Petitioner.*

Of Counsel:

Reed, Smith, Shaw & McClay
747 Union Trust Building
Pittsburgh, Pennsylvania

(S.) CHARLES OLIPHANT
JTR
*Chief Counsel*
*Bureau of Internal Revenue.*

13 OPINION

Docket No. 30821. Promulgated August 13, 1952.

1. Where a lump sum of money is received in settlement of various claims, an allocation of specific amounts to each of the several claims is necessary and proper.

2. Sums received in settlement of punitive damages do not constitute taxable income.

3. Sums received in settlement of claims for anticipated profits are taxable as ordinary income.

*Sidney B. Gambill, Esq.*, for the petitioner.
*Albert J. O'Connor, Esq.*, for the respondent.

The respondent has determined deficiencies of $31.82 and $126.-361.06 in the petitioner's income tax liability for the taxable years ending September 30, 1947, and September 30, 1948, respectively.

The petitioner contests the deficiency determined for the taxable year 1948 which results from the inclusion as ordinary income of the proceeds received in a compromise settlement of various claims.

All stipulated facts are found as stipulated.

## Findings of Fact

The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the taxable year 1948 the petitioner's
14 income tax return was filed with the collector of internal revenue for the twenty-third district of Pennsylvania.

For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license agreements were without restrictions as to the type of glass containers that could be manufactured by the petitioner.

Early in 1923, Hartford-Empire Company (hereinafter referred to as Hartford) representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles, and certain other items. Each Hartford license agreement contained a provision permitting its termination by petitioner upon the payment of a prescribed lump sum minimum royalty. From 1923 until 1931, petitioner used and operated only glass feeding machines under the Hartford license agreements, and pursuant to such agreements petitioner paid royalties to Hartford from 1923 through the fiscal year ended September 30, 1931.

15 The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July 1931, and a 5-year exclusive distribution contract for the sale of its entire fruit jar output was executed with a distributor in September of that year. In December 1932 the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

In 1931 and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During that period, Haub developed and built in petitioner's plant a new feeder known as the Shawkee feeder. Petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. By October 19, 1934, the date of the permanent injunction hereinafter referred to, petitioner had seven royalty-free Shawkee feeders in operation in its plant and was manufacturing 65 per cent of its total production on these machines. It had by then replaced five Howard (Hartford licensed) feeders. The Shawkee feeder proved
16 to be an efficient, workable feeder, equal to those covered by the Hartford licenses.

On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Shawkee Manufacturing Co., et al.*, Docket No. 2791. On the basis of an earlier decision, in *Hartford-Empire Co.* v. *Hazel-Atlas Glass Co.*, 59 F. 2d 399, the complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner.

Relying upon its earlier decision in the *Hazel-Atlas* case, the Circuit Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction, with an opinion reported at 68 F. 2d 726. Pursuant to the mandate of the Circuit Court, the United States District Court for the Western District of Pennsylvania entered an order for a permanent injunction on October 19, 1934. The permanent injunction enjoined the use of Shawkee feeders

by petitioner for the manufacture of any and all glassware, and ordered an accounting. Upon the entry of the permanent injunction, the royalty-free Shawkee feeders were dismantled by petitioner. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Hartford licensed feeders and to pay royalties. Were it not for the permanent injunction, the petitioner would have
17 continued to install royalty-free Shawkee feeders to replace the Hartford licensed feeders.

The accounting directed by the permanent injunction was finally concluded by a settlement between the parties in 1939, whereby petitioner paid Hartford the sum of $11,167.85. A final decree in Docket No. 2791 was thereupon entered in 1939.

In 1939, the United States instituted a civil action in the United States District Court for the Northern District of Ohio, in which Hartford was ultimately held to have violated the Federal antitrust laws. *United States* v. *Hartford-Empire Co.*, 46 F. Supp. 541. The judgment of the District Court finding and holding that Hartford had violated the antitrust laws was affirmed by the United States Supreme Court. *Hartford-Empire Co.* v. *United States*, 323 U. S. 386; 324 U. S. 570.

After December 1940, petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision resulted from information disclosed in the antitrust proceedings prosecuted against Hartford by the United States. Hartford thereupon filed an action for royalties against petitioner in 1941 in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Glenshaw Glass Co.*, Civil Action No. 1650. Following the disclosures made in the Government's antitrust case, the petitioner filed an answer and counterclaim asking for a return of certain royalties and treble damages for destruction of certain lines of its business in violation of the antitrust laws. Hartford's motion to strike the petitioner's counterclaim on the ground that it stated no cause of action was
18 denied in 1942. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

Also, following the disclosures in the Government's antitrust case, petitioner instituted proceedings to reopen and set aside the permanent injunction entered against it in 1934 in Docket No. 2791. Petitioner charged that the judgment which Hartford had obtained against Hazel-Atlas Glass Company had been secured through fraud, and that the Hazel-Atlas judgment was fraudulently employed to secure the permanent injunction against petitioner in

1934. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing, and the applications to vacate the judgments were denied by the Circuit Court of Appeals for the Third Circuit, by a divided court. On appeal, the Supreme Court of the United States in 1944 ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the ground of fraud. The Supreme Court ordered that the fraudulently obtained injunction entered against the petitioner in 1934 be annulled and set aside, that Hartford's complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Docket No. 2791, seeking
19 compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount, based upon the findings of fraud made by the Supreme Court. The District Court denied all of the petitioner's claims for damages except the claim for $11,167.85 paid by petitioner to Hartford in 1939, in settlement of the accounting order above referred to.

The District Court found as a fact that on or about June 6, 1939, the petitioner paid $11,167.85 to Hartford in settlement of the accounting ordered by the District Court in 1934; that royalties paid by the petitioner to Hartford between January 1, 1934, and October 1944 aggregated $397,199.42; that subsequent to the beginning of suit, the petitioner expended $21,850.47 in litigation and travel expenses; that the expenses incurred by the petitioner in dismantling the Shawkee feeders totaled $11,920.15. The District Court made no specific finding of fact with respect to the amount of the loss on the fruit jar business.

The evidence relative to the damage claimed for destruction of the fruit jar business was directed toward a showing of lost profits. Testimony and exhibits were introduced to support an estimate of the profits lost during the period beginning 1934 and ending in 1940, the year in which Hartford's license restrictions on the manufacture of glass jars were removed.

Both petitioner and Hartford appealed to the United States Circuit Court of Appeals for the Third Circuit from the judgment entered by the District Court. In the Circuit Court, petitioner

pressed its demands for the following items and amounts of damages, all of which claims were opposed by Hartford:

20

| Item | Amount | Interest at 6 per cent to Jan. 1, 1947 | Total |
|---|---|---|---|
| Settlement of accounting order | $11,167.85 | $5,074.22 | $16,242.07 |
| Reimbursement of royalties paid to Hartford after Jan. 1, 1934 $397,199.42-$26,283.33)* | 379,916.09 | 189,085.55 | 569,001.64 |
| Litigation and travel expenses | 21,850.47 | 2,872.50 | 24,722.25 |
| Loss on dismantling Shawkee feeders | 11,920.15 | 8,727.50 | 20,647.65 |
| Loss on destruction of fruit jar business | 292,500.00 | 162,373.54 | 454,873.54 |
| Total | $708,354.56 | $368,133.31 | $1,076,487.15 |
| Punitive damages (in an amount equal to the total amount of restitution and compensatory damages) | | | |

* This $26,283.33 item is not involved in the present proceeding.

In the brief submitted on its appeal from the District Court's judgment entered in 1946, the petitioner stated that "Recovery was sought in the counterclaim for the the loss of the fruit jar business and reasonably anticipated profits." In a memorandum to the petitioner dated October 1, 1948, counsel for the petitioner in both suits against Hartford stated that in Civil Action No. 1650, "The principal items of damage were (i) injury to business by limitations and exclusions from various fields (ii) loss of profits and (iii) royalty and other expenses."

The Circuit Court of Appeals, on August 14, 1947, filed its opinion and held as follows:

(a) Settlement of accounting order. The judgment of the District Court allowing petitioner's claim in the amount of $11,167.85, with interest at 6 per cent, was affirmed.

(b) Royalties. Petitioner's claim for royalties, plus interest, was upheld. However, the court stated that "There may be elements which might possibly affect the amounts of royalties to be
21 refunded and we express no opinion as to this." The case was remanded for the taking of additional testimony, and a determination by the District Court of the specific amounts of royalties to be refunded.

(c) Litigation and travel expenses. Petitioner's claim was upheld.

(d) Dismantling Shawkee feeders. Petitioner's claim was upheld.

(e) Destruction of fruit jar business. The finding of the District Court that the evidence as to this loss was too speculative was affirmed as having "substantial justification" in the record.

(f) Punitive damages. The Court said that "This case calls for such damag. although it is for the District Court, as the trier of fact, to assess them, taking into consideration the whole wretched scheme as ascertained and etched in unmistakable terms by the Supreme Court." The Court further stated that the trial court

could be governed by "the enormity of [the] offense rather than the measure of compensation."

Hartford had earned large profits as a result of its fraudulent practices.

Both Hartford and the petitioner filed petitions for rehearing with the Circuit Court of Appeals, and Hartford filed "comments" upon the petitioner's petition for rehearing. Hartford's petition for rehearing argued for complete freedom from liability under all of petitioner's claims. The petition filed by petitioner sought to persuade the Court to direct the entry of a judgment for the full amount of the royaltes it had paid, plus interest. Petitioner
22 also asserted that the Court's ruling denying recovery for the destruction of the fruit jar business rested on errors of law, as well as fact, and disregarded controlling decisions of the United States Supreme Court. In reply, Hartford continued to assert its position that it was entitled to substantial credits against the royalties to be refunded to petitioner. The petitions for rehearing were denied by the Circuit Court of Appeals on October 1, 1947.

While the petitions for rehearing were pending, settlement discussions between petitioner and Hartford were commenced. Petitioner's executive officers and counsel had agreed among themselves to ask for $1,530,000, consisting of the following items:

| | | |
|---|---|---|
| Accounting settlement; litigation and travel expenses; dismantling Shawkee feeders | | $45,000 |
| Reimbursement of royalties paid to Hartford | | 370,000 |
| Loss on destruction of fruit jar business | | 250,000 |
| Punitive damages in Docket No. 2791 | | 500,000 |
| Civil Action No. 1650 (antitrust suit): | | |
| Loss or destruction of lines of glassware other than fruit jar business | $55,000 | |
| Punitive damages | 110,000 | |
| | | 165,000 |
| Interest on refund of royalties and other reimbursement items | | 200,000 |
| | | $1,530,000 |

Petitioner's counsel, in Civil Action No. 1650 and Docket No. 2791, was convinced and so advised the petitioner's president at the time negotiations for settlement began and at the time Hartford's final offer in settlement was received that upon remand of Docket No. 2791 to the District Court, the petitioner would probably receive punitive damages of approximately $500,000 to $750,000 and possibly $1,000,000 or $1,500,000; and further, that if the District Court awarded as punitive damages a sum of $250,-
23 000 or less, it would very likely be reversed upon appeal to the Circuit Court of Appeals. Counsel was of the view that such a large award would be made in view of such factors as the Circuit Court of Appeals' scathing denunciation of the fraud prac-

ticed by Hartford, the large profits it earned during the years the fraud was practiced, and the Circuit Court of Appeals' statement that the District Court, in assessing the punitive damages, could be governed by the enormity of the offense rather than the measure of compensation. The claims for punitive damages under Civil Action No. 1650 and Docket No. 2791 were serious claims, and figured prominently in the final settlement.

The $250,000 claim for loss on the fruit jar business was included in the total sum of $1,530,000 asked by the petitioner in settlement, mainly for bargaining purposes. Since the claim was disallowed by the District Court and the disallowance was affirmed on appeal, the petitioner was prepared to abandon it immediately. Throughout the negotiation proceedings, the representatives of Hartford took the position that the question of the allowance of that claim had been resolved by litigation and they would, therefore pay no attention to it.

The claim for compensatory and punitive damages under Civil Action No. 1650 (antitrust suit) in the amount of $165,000 consisted of $55,000 as the value placed on the claims for destruction of lines of glassware business other than the fruit jar line, and $110,000 as the value assigned to the punitive damages claim. The claims for destruction of the fruit jar line and for return
24 of royalties had also been alleged in Civil Action No. 1650.

The itemized proposal was communicated to representatives of Hartford at a meeting in September 1947. Hartford expressed a willingness to pay a sum in the area of $200,000 but any discussion of settlement in that range was declined. Thereafter, in October 1947, Hartford made a lump sum settlement offer of $600,000 to petitioner, which was rejected. In November 1947 Hartford offered the lump sum of $813,358.24. This offer was accepted by petitioner, and the settlement agreement was executed on December 15, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court.

The settlement terminated the litigation in Civil Action No. 1650 and Docket No. 2791, referred to above, and was evidenced by a settlement agreement and two mutual releases. Pursuant to the settlement agreement, Hartford paid petitioner the sum of $813,358.24 on December 23, 1947. No agreement was made by the parties to the settlement as to the allocation of that amount among the various claims involved in the litigation and settlement negotiations.

In the fiscal year ended September 30, 1948, petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

In its income tax return for the taxable year 1948, the petitioner reported the total proceeds of $813,358.24 from which it deducted

$225,000 for attorney fees, leaving a balance of $588,358.24 as the net proceeds. This balance was allocated to the various claims by according to each claim that proportion of the net settle-
25 ment proceeds ($588,358.24) which the value gives to such claim (under the breakdown given to Hartford in the original settlement offer of $1,530,000) bears to the total value of $1,530,000 assigned to all claims. The computation was as follows:

| | Value under $1,530,000 offer | Percentage of total value of $1,530,000 assigned to all claims | Allocated net proceeds of $588,358.24 |
|---|---|---|---|
| Settlement of accounting order litigation and travel expenses, dismantling Shawkee feeders | $45,000 | [1] 2.9 | $17,062.39 |
| Reimbursement of royalties paid to Hartford | 370,000 | [1] 24.2 | 142,382.69 |
| Loss on destruction of fruit jar business | 250,000 | [2] 16.3 | 95,902.40 |
| Punitive damages in Docket No. 2791 | 500,000 | [2] 32.7 | 192,393.14 |
| Civil Action No. 1650 (antitrust suit): | | | |
| Loss on destruction of lines of glassware business other than fruit jar business | 55,000 | [2] 3.6 | 21,180.90 |
| Punitive damages | 110,000 | [2] 7.2 | 42,361.79 |
| Interest | 200,000 | [1] 13.1 | 77,074.93 |
| | $1,530,000 | 100.0 | $588,358.24 |

[1] On the schedule attached to the income tax return, these three items were combined at a total percentage of 40.20, and a total sum of $26,520.01.

[2] On the schedule attached to the income tax return, these four items were combined at a total percentage of 59.80, and a total sum of $351,838.23. The two items under Civil Action No. 1650 (antitrust suit) were totaled at $165,000 and referred to as "Damage to Business Covered by Antitrust suit." No part of the $165,000 sum was referred to as punitive damages.

The net effect of the computation was to allocate to each claim an amount equal to approximately 38.45 per cent ($588,358.24 ÷ $1,530,000) of the amount assigned to it in the breakdown of the original settlement offered to Hartford.

The sum of $813,358.24 received as a lump sum settlement of all claims that petitioner had against Hartford should be apportioned among the several claims in the ratio that this sum bears to the total sum of $1,530,000 claimed in the petitioner's original settlement offer.

The $225,000 in legal fees incurred by the petitioner in the litigation and settlement of the claims against Hartford should be allocated between the claims in the same proportion as the
26 $813,358.24 received in settlement is allocated to the several claims. The fees allocated to the claims that give rise to taxable income constitute an ordinary and necessary business expense.

In its claims for loss due to destruction of the fruit jar and other

lines of glassware business, asserted in the lawsuits and in the settlement negotiations that followed, the petitioner sought recovery for loss of anticipated profits and not for lost capital.

## OPINION

ARUNDELL, *Judge*: The basic issue before us is the taxability of a sum of money received by the petitioner in 1947 in compromise settlement of several claims asserted against Hartford-Empire Company (hereinafter referred to as Hartford) in two suits and in subsequent settlement negotiations. The claims were for: (1) reimbursement of the sum paid in settlement of the accounting order; (2) reimbursement of litigation and travel expenses; (3) reimbursement of loss incurred in dismantling Shawkee feeders; (4) reimbursement of royalties paid to Hartford; (5) interest on refund of royalties and other reimbursement items; (6) loss due to destruction of fruit jar business; (7) loss due to destruction of various lines of glassware business other than the fruit jar business; (8) punitive damages under section 4 of the Clayton Act (15 U. S. C. A., Title 15, section 15) for violation of Federal antitrust laws resulting in destruction of various lines of glassware business other than the fruit jar business, and (9) punitive damages for loss caused by Hartford's fraudulent practices.

27 The taxable nature of the sum received in settlement of each of those claims is dependent upon the nature of the claim. That is, a sum received in settlement of a claim for a nontaxable item is nontaxable whereas it would be taxable as ordinary income if the item claimed was an ordinary income item, or taxable as a return of capital if the claim was for recovery of lost capital. *Raytheon Production Corporation* v. *Commissioner*, 144 F. 2d 110, certiorari denied 322 U.S. 777; *Durkee* v. *Commissioner*, 162 F. 2d 184, and cases cited therein.

The parties seem to be in agreement that the sums received in settlement of the first five claims are taxable as ordinary income. The respondent has determined that they constitute ordinary income, and petitioner has offered no evidence or argument to the contrary.

The first issue is whether the sums received in settlement of the punitive damages claims constitute taxable income. It has long been established that punitive damages do not meet the test of taxable income set forth in *Eisner* v. *Macomber*, 252 U.S. 189, 193, as "' * * * the gain derived from capital, from labor, or from both gained through a sale or conversion of capital assets * * *.'" *Central R. Co.* v. *Commissioner*, 79 F. 2d 697; combined', provided it be understood to include profit *Highland Farms Corporation*, 42 B. T. A. 1314. This basic definition has been recently cited with complete approval in *Commissioner* v. *Culbertson*, 337 U.S. 733,

740, and has been adhered to by the respondent in his Regulations 111, section 29.22(a)-1. Therefore, on the authority of those cases, we follow this rule of long standing that has never
28 been questioned in any court and hold that the sums received in settlement of the punitive damages claims do not constitute taxable income.

The taxability of the sums received in settlement of the claims for loss due to destruction of the fruit jar and other lines of glassware business is in issue because the parties disagree as to what the taxpayer sought to recover. The petitioner contends it sought recovery of lost capital only, and the respondent contends that recovery for the loss of anticipated profits was sought. Whether or not the sums received in settlement of those claims are taxable as a return of capital or as ordinary income is dependent upon the resolution of this question of fact. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn*, 186 F. 2d 450; *Mathey* v. *Commissioner*, 177 F. 2d 259, affirming 10 T.C. 1099.

The petitioner, in support of its contention that it sought to recover only lost capital, relies on the fact that in these claims the destruction of the business was alleged. However, destruction of a business is a factual premise that might support a claim based on the loss of anticipated profits as well as the loss of capital. We must, therefore, look further to determine what the petitioner sought to recover.

The pleadings in both suits Nos. 1791 and 1650 fail to refer to any asset, either tangible or intangible, that was damaged or destroyed. There is no allegation that any physical assets became idle or useless because of the prohibition against the manufacture of certain lines of glassware but, on the contrary, we know
29 that the same machinery used to manufacture the prohibited glassware was also used to manufacture other unprohibited lines of glassware. Intangibles such as "good will" or "reputation" are nowhere mentioned and there is no contention that with reference to the prohibited lines of glassware business the petitioner had acquired "good will" or that sums had been expended and capitalized in the development of those lines. *Martin Brothers Box Co.* v. *Commissioner*, 142 F. 2d 457.

No evidence was introduced in the litigated suit or in this proceeding to establish at least that there had been in existence an asset, later destroyed, that could conceivably have been the basis of a claim for lost capital. The petitioner offered no evidence of customers' lists, schedule of valuable established merchandise outlets for those wares, testimony of preference given to those wares by customers, or similar evidence likely to be introduced where loss of good will or a similar asset is in issue. In fact, the evidence

establishes that the petitioner's fruit jar business was not begun until July 1931 and, further, that in September of that year the petitioner gave to a distributor a 5-year exclusive distribution contract for the sale of its entire fruit jar output.

The evidence in the litigated suit consisted mainly of a showing of loss of anticipated profits. Testimony and exhibits were introduced to support an estimate of the profits that would have been earned during the period beginning 1934 and ending with the removal in 1940 of the prohibitions against the manufacture of fruit jars. The significance of the petitioner's reliance on such evidence is not lessened because evidence of past profits ac-
30 tually earned is sometimes introduced to value good will. See *Raytheon Production Corporation* v. *Commissioner*, *supra*. It is very unlikely that the petitioner attempted to prove the value of good will by estimated anticipated profits. In any event, such a purpose cannot be inferred when there is no reference to good will or any similar asset that might need to be valued. Finally, we must note that the Circuit Court of Appeals for the Third Circuit characterized that claim as a "claim for loss of profits." *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 F. 2d 474, 479.

After carefully studying this and all other evidence, especially the exhibits and testimony pertinent to suits Nos. 2791 and 1650, and subsequent discussions between Hartford and the petitioner, we find the posture of the litigation and settlement negotiations to be such that on the record before us we cannot find that the recovery sought was for lost capital but, on the contrary, find that recovery was sought for the loss of anticipated profits. Therefore, the sums received in settlement of those claims represent recovery for the loss of anticipated profits and are taxable as ordinary income. *Raytheon Production Corporation* v. *Commissioner*, *supra*; *Durkee* v. *Commissioner*, *supra*; *Jones* v. *Corbyn*, *supra*; *Mathey* v. *Commissioner*, *supra*.

However, even if the evidence established that the petitioner sought recovery only in part for loss of anticipated profits, the entire proceeds would represent a recovery for the loss of anticipated profits. The respondent has in effect determined that none of the settlement proceeds represented a return of capital, and the petitioner has relied entirely on the proposition that recovery
31 was solely for lost capital and that the proceeds received in settlement represent a return of capital. The petitioner therefore made no attempt to, and the record does not contain any evidence on the basis of which we could, apportion the settlement proceeds between recovery of lost capital and recovery for loss of anticipated profits. Under such circumstances, the entire sum received in settlement of those claims represents a recovery for

loss of anticipated profits and is taxable as ordinary income. *Armstrong Knitting Mills*, 19 B. T. A. 32; *Arcadia Refining Co.* v. *Commissioner*, 118 F. 2d 1010; *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932; *Martin Brothers Box Co.* v. *Commissioner*, *supra*.

Finally, we must determine what portion of the $813,358.24 settlement proceeds is allocable to the punitive damages claims and how much is allocable to the remaining claims which give rise to taxable income. Since the entire sum allocable to the remaining claims is taxable as ordinary income, it is not necessary that we determine what portion is allocable to each individual item in that category.

The parties to the compromise settlement merely agreed to a lump sum payment and made no attempt to decide how much was paid and received in settlement of each claim or how much was attributable to the punitive damages claims. Under those circumstances, an allocation is necessary and proper. *Specialty Engineering Co.*, 12 T. C. 1173; cf. *Cramp Shipbuilding Co.*, 17 T. C. 516; see *Helvering* v. *Safe Deposit & Trust Co.*, 316 U.S. 56.

32 The petitioner proposes that we allocate to the punitive damages claims that proportion of the gross settlement proceeds ($813,358.24) which the value assigned to those claims by the petitioner at the beginning of settlement negotiations bears to the total value ($1,530,000) assigned to all claims at that time. Pursuant to that proposal, petitioner allocated $324,529.94 to the punitive damages claims and the balance to the remaining claims.

We accept the general method of allocation proposed by the petitioner as a reasonable one which in our opinion is fair to the respondent, and in so doing we are not unmindful of the respondent's objection that this method ignores the relative weight possessed by those various claims. However, we do not deem this material since the respondent does not suffer from the allocation as proposed. The failure to take into account relative weight did not increase, and possibly decreased, the amount of the settlement proceeds allocated to the punitive damages claims. For example, by giving equal weight to the claim for destruction of the fruit jar business, admittedly the weakest claim, the amount allocated to ordinary income was proportionately increased and the amount allocated to the punitive damages claims was proportionately decreased.

Furthermore, not only did the claims for punitive damages possess more weight than the claim for destruction of the fruit jar business but, in addition, we think they possessed at least approximately the same weight as all other claims, other than the first three relatively small claims totaling $44,938.47 and the interest thereon.

33 The claims for punitive damages, especially the claim in No. 2791, were serious claims that undoubtedly figured prominently in the settlement negotiations and final settlement agreement. In No. 1650, the petitioner pressed a claim for treble damages under section 4 of the Clayton Act. Hartford had already been found guilty of violating Federal antitrust laws and the judgment was affirmed by the United States Supreme Court. In No. 2791, the Circuit Court of Appeals for the Third Circuit ruled that the petitioner should receive punitive damages and prepared the way for a large award by scathingly denouncing the fraud of which the petitioner had been a victim, and by stating that "In those circumstances, the trial court has power to inflict such damages, 'having in view the enormity of * * * [the] offense rather than the measure of compensation * * * .'" Hartford had earned large profits as a resuult of those fraudulent practices.

The sum of $813,358.24 received as a lump settlement will be apportioned in the manner set forth in our findings and the tax thereon will be computed as we have determined herein.

The parties have agreed that the legal fees incurred in the litigation and settlement of the several claims against Hartford should be allocated between the claims in the same proportion as the settlement proceeds are allocated. They further agreed that the fees allocated to the claims that gave rise to taxable income are deductible as an ordinary and necessary business expense, and that the fees allocated to the claims that did not give rise to taxable income are not deductible.

*Decision will be entered under Rule 50.*

34

DECISION

Pursuant to the Opinion of the Court promulgated August 13, 1952, the respondent herein, on December 1, 1952, filed a recomputation for entry of decision, the petitioner's acquiescence in the respondent's recomputation being noted thereon. Wherefore, it is

ORDERED and DECIDED: That there is no deficiency in income tax for the taxable year ended September 30, 1948, and that there is an overpayment in income tax for the taxable year ended September 30, 1948, in the amount of $85,709.20, all of which was paid after the mailing of the notice of deficiency.

Entered: Dec. 3, 1952

(Signed) ERNEST H. VAN FOSSAN
*Judge.*

35 The Tax Court of the United States

Docket No. 29450

WILLIAM GOLDMAN THEATRES, INC., *Petitioner*

*v.*

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

DOCKET ENTRIES

1950

July 7. Petition received and filed. Taxpayer notified. Fee paid.

July 7. Copy of petition served on General Counsel

Aug. 4. Answer filed by General Counsel.

Aug. 4. Request for Hearing in Philadelphia, Penna. filed by General Counsel.

Aug. 8. Notice issued placing proceeding on Philadelphia calendar. Service of Answer and Request made.

Dec. 19. Hearing set February 26, 1951, Philadelphia, Penna.

1951

Jan. 18. Motion for continuance to the next Philadelphia calendar filed by petitioner. 1/19/51—Granted.

June 25. Hearing set September 17, 1951, Philadelphia, Pa.

Aug. 10. Entry of appearance of Samuel H. Levy, as counsel filed.

36 Aug. 10. Entry of appearance of Bernard Wolfman as counsel filed.

Aug. 15. Motion for continuance to next Philadelphia calendar filed by taxpayer. Granted.

Aug. 21. Entry of appearance of D. Hays Solis-Cohen, as counsel filed.

Aug. 28. Motion to withdraw as counsel Daniel J. Hanlon, filed. Granted as to J. Daniel Hanlon.

Nov. 8. Hearing set January 21, 1952, Philadelphia, Pa.

1952

Jan. 21. Hearing had before Judge Johnson on merits. Stipulation of facts with exhibits filed. Briefs March 21, 1952. Replies April 30, 1952.

Jan. 30. Transcript of Hearing 1/21/52 filed.

Mar. 10. Joint motion to correct official record filed. Granted.

Mar. 14. Motion for extension to May 20, 1952 to file brief, filed by General Counsel. 3/19/52 Granted to May 21, 1952.

1952

Mar. 18. Motion for extension to May 21, 1952 to file brief, filed by taxpayer. 3/19/52—Granted.

May 20. Brief filed by taxpayer. Copy served 5/21/52.

May 20. Brief filed by General Counsel.

June 19. Reply Brief filed by General Counsel.

June 20. Reply Brief filed by taxpayer. 6/20/52 copy served.

Nov. 28. Motion for leave to file the attached supplemental reply brief, brief lodged filed by taxpayer. 12/2/52—Granted. 12/3/52 Copy served.

1953

Jan. 9. Findings of Fact and Opinion rendered. Judge Johnson. Decision will be entered under Rule 50. Copy served.

37 Mar. 18. Agreed Computation for entry of decision filed.

Mar. 25. Decision entered. Le Mire, Judge. Div. 5.

June 24. Petition for Review by U. S. Court of Appeals for the Third Circuit filed by General Counsel.

June 24. Notice of filing petition for review mailed to Samuel H. Levy, filed.

June 30. Proof of Service of filing petition for review from Samuel H. Levy, filed.

July 23. Proof of Service of petition for review filed.

July 29. Motion for extension of time to 9/22/53 to prepare, transmit and deliver record on review, filed by General Counsel.

July 30. Order enlarging time to 9/22/53 to file and docket record on appeal, entered.

Aug. 21. Motion to retain original exhibits until 10 days prior to hearing filed by General Counsel.

Aug. 24. Statement Re Diminution of record filed by Respondent with statement of service thereon.

Aug. 25. Order of Tax Court directing that original exhibits be held here until 10 days before hearing, entered.

## Stipulation of Facts

It is hereby stipulated with respect to the above captioned proceeding that the following statements may be accepted as facts and that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence at the trial of this case not inconsistent with the facts herein stipulated.

1. The petitioner is a Delaware corporation duly authorized to do business in the Commonwealth of Pennsylvania and has its principal place of business in the Goldman Theatre Build-

38 ing, 15th and Chestnut Streets, Philadelphia, Pennsylvania.

2. The petitioner's income tax return for the taxable year

1948, the year herein involved, was filed with the Collector of Internal Revenue for the First District of Pennsylvania at Philadelphia.

3. The taxes in controversy are income taxes for the taxable year 1948.

4. The petitioner's business during the year herein involved consisted of the operation of motion picture houses and the exhibition therein of motion pictures produced and distributed by other persons and corporations.

5. On December 8, 1942, the petitioner instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania (Civil Action 2877) against Loew's, Inc., Paramount Pictures, Inc., RKO Radio Pictures, Inc., Twentieth Century Fox Film Corporation, Columbia Pictures Corporation, Warner Bros. Pictures, Inc., Vitagraph, Inc., Warner Bros. Circuit Management Corporation, Stanley Company of America, Inc., Universal Corporation, Universal Film Exchanges, Inc., and United Artists Corporation. A copy of the Complaint filed by the petitioner, as plaintiff in the action, is attached hereto, made part hereof, and designated Exhibit "1-A".

6. After the case was at issue, the District Court heard evidence relating to the primary issue of the existence of a conspiracy, on the basis of which judgment was entered in favor of the defendants therein: *William Goldman Theatres, Inc.* v. *Loew's, Inc.*
39 *et al.*, 54 F. Supp. 1011 (D.C., E.D., Pa. 1944), which opinion is incorporated herein by reference.

7. On appeal, the Court of Appeals for the Third Circuit reversed the judgment of the District Court, holding that a conspiracy existed as charged: *William Goldman Theatres, Inc.* v. *Loew's, Inc. et al.*, 150 F. 2d 738 (C.A. 3rd 1945), which opinion is incorporated herein by reference.

8. Pursuant to an agreement of the parties, the petitioner offered no evidence relating to the issue of damages at the first stage of the trial, pending the Court's decision on the question of liability under the Sherman Act. After the Court of Appeals for the Third Circuit held the evidence sufficient to sustain the charge of conspiracy in restraint of trade, the District Court heard evidence directed solely to the question of damages.

9. On September 10, 1946, the District Court Judge made his findings with respect to damages, which damages were based on the petitioner's loss of profits at the Erlanger Theatre. The Court's finding is as follows:

> "I, therefore, find as a fact that the plaintiff, but for the wrongful acts of the defendants, would have earned profits at the Erlanger Theatre amounting to $125,000 during the damage period."

The opinion of the District Court Judge setting forth his findings of fact and his conclusions of law with respect to the dam-
40 age question is officially reported as *William Goldman Theatres, Inc.*, v. *Loew's, Inc. et al.*, 69 F. Supp. 103 (D.C., E.D., Pa. 1946), and a copy of that opinion is attached hereto, made part hereof, and designated Exhibit "2-B".

10. On December 18, 1946, the District Court entered a final decree based on the findings as set forth in the opinion of September 10, 1946. Paragraph 4 thereof provides:

> "The amount of the plaintiff's damages is $125,000 and the defendant shall pay to the plaintiff threefold that amount, or $375,000. Interest to date is not allowed."

A copy of said decree is attached hereto, made part hereof, and designated Exhibit "3-C".

11. On January 7, 1947, the defendants filed an appeal from said decree with the Court of Appeals for the Third Circuit. Prior to argument of said appeal, however, the defendants petitioned the Court of Appeals for the Third Circuit for leave to apply to the District Court for permission to file a Bill of Review. The petition was denied on August 11, 1947, in an opinion officially reported as *William Goldman Theatres, Inc.* v. *Loew's, Inc. et al.*, 163 F. 2d 241 (C. A. 3rd 1947), which opinion is incorporated herein by reference.

12. On January 6, 1948, the Court of Appeals for the Third Circuit affirmed the judgment of the District Court in a *per curiam* opinion: *William Goldman Theatres, Inc.* v. *Loew's, Inc. et al.*, 164 F. 2d 1021 (C.A. 3rd 1948), which opinion is incorporated herein by reference. Certiorari was subsequently denied by the Supreme Court of the United States, 334 U. S. 811
41 (1948).

13. On May 28, 1948, the defendants, pursuant to paragraph 4 of said decree, paid the petitioner the sum of $375,000.

14. Of the foregoing amount of $375,000, the petitioner, in its income tax return for the year 1948, included in gross income the amount of $125,000. The balance of the $375,000 was not included in the petitioner's gross income for the year herein involved.

15. The amount of $4423 disallowed by the respondent in the notice of deficiency dated April 12, 1950, represents expenditures for capital items in the taxable year 1948 and is not deductible in said year. It is agreed that a decision on such basis may be entered under Rule 50 of The Tax Court's Rules of Practice.

16. In addition to the amount heretofore allowed to the petitioner by respondent as a deduction from gross income for Pennsylvania foreign franchise tax for the taxable year 1948, petitioner is entitled to deduct $2750 for Pennsylvania foreign franchise tax. It

is agreed that a decision on such basis may be entered under Rule 50 of The Tax Court's Rules of Practice.

(S.) SAMUEL H. LEVY,
(S.) BERNARD WOLFMAN,
*Counsel for Petitioner,*
(S.) MASON B. LEMON,
J.F.W.
*Acting Chief Counsel*
*Bureau of Internal Revenue.*

42 FINDINGS OF FACT AND OPINION OF THE TAX COURT

Docket No. 29450. Promulgated January 9, 1953

*Income—Punitive Damages.*—Petitioner, as an injured party, received a damage judgment in an antitrust suit. *Held*, one-third of the award was compensatory damages for loss of profits and taxable as income. *Held, further*, that two-thirds of the award was punitive damages and not taxable.

*Samuel H. Levy, Esq.*, and *Bernard Wolfman, Esq.*, for the petitioner.

*Jules I. Whitman, Esq.*, for the respondent.

The respondent determined deficiencies in petitioner's income tax for the years 1947 and 1948 in the amounts of $1,847.19 and $92,874.70, respectively. The deficiency determined for the year 1947 is not in issue.

Two of the three allegations of error for the year 1948 were resolved by stipulation of the parties. The sole remaining issue before us is whether a two-thirds portion of the aggregate award received by petitioner in an antitrust suit was taxable income.

## Findings of Fact

The facts are stipulated and are so found.

The petitioner is a Delaware corporation authorized to do business in the Commonwealth of Pennsylvania and has its principal place of business at Philadelphia, Pennsylvania. Petitioner's
43 income tax return for 1948 was filed with the collector of internal revenue for the district of Pennsylvania.

Petitioner's business during the year 1948 consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations. On December 8, 1942, petitioner instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania against certain motion picture distributors; peti-

tioner alleged that the named defendants violated the Federal antitrust laws. The action was brought under section 4 of the Act of Congress of October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies and for other purposes," as amended and supplemented (15 U.S.C.A. 15), commonly known as the Clayton Act, and sections 1 and 2 of the Act of Congress of July 2, 1890, entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (15 U.S.C.A. 1), said Act being commonly known as the Sherman Anti-Trust Act, and the Act of Congress of June 19, 1936 (15 U. S. C. A. 13), commonly known as the Robinson-Patman Act. Petitioner's complaint was in part as follows:

> 28. As a result of the discrimination against plaintiff which defendants accomplished through said monopoly, plaintiff has been unable to operate the Erlanger Theatre and has thereby suffered great loss and damage, to wit, the sum of $450,000.00.
>
> 44 WHEREFORE, plaintiff prays:
>
> * * * * *
>
> (e) That the defendants be decreed to pay to the plaintiff triple all such damages as may have been sustained by the plaintiff as above, to wit, the sum of $1,350,000.00.

After the case was presented to the district court a judgment was entered in favor of the defendants. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 54 F. Supp. 1011.

On appeal the United States Court of Appeals for the Third Circuit reversed the judgment of the district court; the Court of Appeals held that a conspiracy existed as charged. *William Goldman Theatres, Inc.* v. *Loew's Inc.*, 150 F. 2d 738. Pursuant to an agreement of the parties and pending the court's decision on the question of liability under the Sherman Act, William Goldman Theatres, Inc., offered no evidence relating to the issue of damages at the first stage of the trial. After the Court of Appeals held the evidence sufficient to sustain the charge of conspiracy in restraint of trade, the district court heard evidence directed solely to the question of damages.

On September 10, 1946, the district court made its findings with respect to damages. The damages were based solely on the petitioner's loss of profits at the Erlanger Theatre. The court's findings is as follows:

> I, therefore, find as a fact that the plaintiff, but for the wrongful acts of the defendants, would have earned profits at
> 45 the Erlanger Theatre amounting to $125,000 during the damage period.

*William Goldman Theatres, Inc.* v. *Loew's Inc.*, 69 F. Supp. 103.

On December 18, 1946, the district court entered a final decree based on the findings as set forth in the opinion of September 10, 1946. Paragraph four of the opinion provides:

> The amount of the plaintiff's damages is $125,000 and the defendant shall pay to the plaintiff threefold that amount, or $375,000. Interest to date is not allowed.

On January 6, 1948, the Court of Appeals for the Third Circuit affirmed the judgment of the district court in a *per curiam* opinion. *William Goldman Theatres, Inc.* v. *Loew's Inc.*, 164 F. 2d 1021. Certiorari was denied by the United States Supreme Court, 334 U.S. 811.

On May 28, 1948, the defendant paid the petitioner the sum of $375,000. Of this amount petitioner, on its income tax return for the year 1948, included in gross income the amount of $125,000. The balance of the $375,000 was not included in petitioner's gross income for the year 1948.

Of the aggregate award of $375,000 petitioner received $250,000 as punitive damages and $125,000 for the loss of profits.

46 JOHNSON, *Judge*: Petitioner has reported as taxable income $125,000 of a total of $375,000 judgment received upon the successful prosecution of an antitrust suit. The award was made under what is commonly known as section 4 of the Clayton Act (15 U.S.C.A. 15)[1]

Respondent maintains that the excess ($250,000) by which the award exceeds the actual damages ($125,000) constitutes taxable income under section 22 (a) of the Internal Revenue Code and the Sixteenth Amendment. Respondent also contends that the entire award in this case was for loss of profits and therefore the entire amount is taxable. Petitioner, in opposition, relies on the contention that the sum of $250,000 constitutes a penalty which is not income and therefore is not taxable.

Two questions must be answered before we ascertain the correctness of respondent's contention. First, we must determine for what purpose the $250,000 was awarded. Was it received in lieu

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[1] §15. Suits by persons injured; amount of recovery.

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. Oct. 15, 1914, c. 323, § 4, 38 Stat. 731.

of profits or capital gain, or was it received as a punitive award under the Clayton Act? Next, if the money was received as a punitive award, is it taxable income?

The district court did not specifically denominate this $250,000 as a particular type of damage; that court, however, did
47 find as a fact that petitioner's damages from loss of profits amounted to $125,000 and under the statute (Clayton Act) it was entitled to threefold the damages sustained. This decision of this district court does not resolve the issue before us; therefore we must look elsewhere.

The words of the Clayton Act, "and shall recover threefold the damages by him sustained," do not in themselves answer our question; we have, therefore, gone into the legislative history of the Sherman Act (section 7, 26 Stat. 210), and the Clayton Act. We have found that even though Congress did not set forth in the statute the words "punitive" or "exemplary" in describing part of the threefold damages, there can be no doubt that Congress intended part of the threefold damages to be compensatory and part to be punitive.[2]

The courts have also interpreted the award in antitrust suits to be composed of both punitive and compensatory damages. The court in *Clark Oil Co.* v. *Phillips Petroleum Co.*, 148 F. 2d 580, 582, said:

> * * * The Sherman Act and the Clayton Act afford a cause of action for those suffering damages. In their provisions for damages they embody both punitive and compensatory damages but no recovery can be had unless a case for compensatory damages is made. In the event of compensatory damages, then automatically the punitive damages follow. * * *;

48 Again, it was said in *Johnson* v. *Schlitz Brewing Co.*, 33 F. Supp. 176, 182, Aff'd. 123 F. 2d 1016, that section 7 of the Sherman Act "was intended to be punitive in nature and deterrent in effect." Further, in *Bigelow* v. *RKO Radio Pictures, Inc.*, 150 F. 2d 877, 883, reversed on other grounds, 327 U.S. 251, it was said:

> * * * The amount of this verdict [under 15 U.S.C.A. 15] was required by statute to be trebled by the judgment. In this respect neither the jury nor either court had any discretion. The verdict should represent actual damages sustained, and two-thirds of the judgment is a penalty which Congress has seen fit to impose in such cases upon a guilty defendant. * * *

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[2] See Bills and Debates in Congress Relating to Trusts, 1903, S. Doc. No. 147, 57th Cong., 2d Sess.; The History of Bills and Resolutions, 51 Cong., Res. Index #160, H. R. 15657, 63rd Cong., 2d Sess.

In other instances the courts have been required to determine whether the threefold damages for antitrust violations were penal in the strict and primary sense in that they were redresses for injuries to the public rather than redresses for wrongs to individuals. In these cases the courts held that the treble damages are either exemplary damages or penalties. *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 232 F. 574, 577; *City of Atlanta* v. *Chattanooga Foundry & Pipeworks*, 127 F. 23, 28, aff'd. 203 U.S. 390.

We have found no case which held that the excess over the actual damages, when the excess was severable from the actual damages, was anything but a penalty, punitive or exemplary damages. Cf. *Durkee* v. *Commissioner*, 181 F. 2d 189, affirming a Memorandum Opinion of this Court; *Durkee* v. *Commissioner*, 162 F. 2d 184, reversing 6 T.C. 773; *Mathey* v. *Commissioner*, 177 F. 2d
49 259, affirming 10 T.C. 1099. We shall not attempt to distinguish between punitive or exemplary damages. For our purposes they shall be considered the same. See 15A Words and Phrases 341. It is proper for us to conclude that the part of the award which represents loss of profits is compensatory in that it makes the injured petitioner whole. Likewise that part of the award in excess of compensation is punitive damages. Of the statutory threefold damages, we conclude that one part is compensatory and two parts are punitive; therefore the $250,000 was awarded as punitive damages.

Following the determination that part of the award is a penalty, we must next ascertain whether it is taxable income. The question of whether penalties are taxable is not new or novel. In a recent decision involving a settlement under an antitrust suit, we held that those sums apportioned to penalties were not taxable as income. *Glenshaw Glass Co.*, 18 T.C.—, (promulgated Aug. 13, 1952). In an earlier case, *Highland Farms Corporation*, 42 B.T.A. 1314, a jury awarded the taxpayer damages for slander of title to its property and for interference with its business, and in addition awarded a sum as exemplary damages. We held that the exemplary damages were not taxable income. On p. 1322 we said: "A penalty imposed by law does not meet the test of taxable income set forth in *Eisner* v. *Macomber*, 252 U.S. 189, as "'the gain derived from capital, from labor, or both combined,' provided it be understood to include profit gained through a sale or conversion of capital asserts." See also, *Central R. Co. of New Jersey* v. *Commissioner*, 79 F.
50 2d 697, where it was held that a penalty imposed by law upon faithless fiduciary was not taxable income.

Respondent would have us hold that these cited cases are no longer authority to be followed in holding that punitive damages are not taxable income. Respondent has cited a great many cases

in support of his contention but has failed to show that punitive damages are taxable as income. Until such time as the *Glenshaw Glass Co.*, the *Central R. Co.*, and the *Highland Farms* cases are overruled, or until Congress by legislation requires that punitive damages be taxable as income, we must follow the established decisions. We think that *General American Investors Co.*, 19 T.C. —, (promulgated Dec. 30, 1952), is distinguished from our present case. In that case the taxpayer did not receive money in payment of punitive damages, but pursuant to a statute which provided certain profits realized by corporate insiders under circumstances there present should "inure to and be recoverable by" the corporation.

We conclude, therefore, that the petitioner shall be sustained as to the $250,000, but the other adjustments in the deficiency notice shall require a Rule 50 computation.

*Decision will be entered under Rule 50.*

DECISION—March 25, 1953.

Pursuant to Opinion of the Tax Court in the above-entitled proceeding promulgated January 9, 1953, respondent filed a
51 computation on March 18, 1953, in which petitioner concurred. Now, therefore, it is

ORDERED AND DECIDED: That there is a deficiency in income tax for the calendar year 1948 in the amount of $523.54.

(Signed) O. P. LEMIRE,
*Judge.*

52-54 MOTION FOR EXTENSION OF TIME TO FILE RESPONDENT'S BRIEF AND ORDER THEREON OMITTED IN PRINTING

55-58 PETITION OF WILLIAM GOLDMAN THEATRES, INC., FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND ORDER THEREON OMITTED IN PRINTING

59 United States Court of Appeals for the Third Circuit

No. 11,073

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

*v.*

GLENSHAW GLASS COMPANY, Respondent.

No. 11,150

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

*v.*

WILLIAM GOLDMAN THEATRES, INC., Respondent

APPEALS FROM THE TAX COURT OF THE UNITED STATES

Argued December 23, 1953

Before BIGGS, *Chief Judge*, and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*.

OPINION OF THE COURT—Filed April 9, 1954

By BIGGS, *Chief Judge*.

The Commissioner seeks to reverse two decisions of the United States Tax Court in favor of two taxpayers. In Glenshaw a claim for punitive damages based upon a competitor's, Hartford's
60 fraudulent suits which disastrously affected the taxpayer's business, as well as a claim for treble damages under Section 4 of the Clayton Act, 15 U. S. C. A. § 15, were settled by the payment of a sum of money.[1] In Goldman a judgment for treble damages was awarded Goldman against Loew's, Inc.,[2] also pursuant to Section 4 of the Clayton Act. The sole question presented for

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[1] For the history of the litigation see: Hartford-Empire Co. v. Shawkee Mfg. Co., 163 F. 2d 474 (3 Cir. 1947); Hartford-Empire Co. v. Shawkee Mfg. Co., 67 F. Supp. 26 (D.C.W.D.Pa. 1946); Hartford-Empire Co. v. United States, 323 U.S. 386 (1945); Hartford-Empire Co. v. Shawkee Mfg. Co., 147 F. 2d 532 (3 Cir. 1944); Shawkee Mfg. Co. v. Hartford-Empire Co., 322 U.S. 271 (1944), reversing Hartford-Empire Co. v. Shawkee Mfg. Co., 137 F. 2d 764 (3 Cir. 1943); Shawkee Mfg. Co. v. Hartford-Empire Co., 68 F. 2d 726 (3 Cir. 1934); and Hartford-Empire Co. v. Hazel-Atlas Glass Co., 59 F. 2d 399 (3 Cir. 1932).

[2] See William Goldman Theatres, Inc. v. Loew's, Inc., 164 F. 2d 1021 (3 Cir. 1948).

our determination is whether moneys paid as punitive or statutory treble damages are taxable as income under Section 22(a) of the Internal Revenue Code.[3] The Tax Court has decided that they are not and the Commissioner of Internal Revenue has petitioned this court for review.[4] Insofar as the issue before us is concerned no valid distinctions can be drawn between a money settlement and money paid in satisfaction of a judgment or between punitive damages levied for fraud and treble damages rendered under the Clayton Act.[5]

61 The positions of the taxpayers are based in large part upon the definition of "income" set out in Eisner v. Macomber, 252 U. S. 189, 207 (1920), on the decision of this court in Central R. Co. v. Commissioner, 79 F. 2d 697 (1935), the decision of the Board of Tax Appeals in Highland Farms Corporation, 42 B. T. A. 1314 (1940), and the applicable Treasury Regulations.[6, 7]

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[3] Section 22(a) of the Internal Revenue Code, in pertinent part, is as follows:

> *"General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

[4] The Tax Court opinions are reported at 18 T. C. 860 (Glenshaw) and 19 T.C. 637 (Goldman). See also Obear Nester Glass Co., 20 T.C. No. 152, and Telefilm, Inc., 21 T.C. —, similar cases.

[5] The Commissioner and Glenshaw do not now dispute that $324,529.94 was the amount paid in settlement of punitive damages. In the Goldman case the amount of actual damage, found to be $125,000, was trebled and a judgment was entered for $375,000. We are concerned solely with the taxability of the sum of $324,529.94 (Glenshaw) and the taxability of $250,000 (Goldman).

[6] The facts of the Central R. Co. case are distinguishable from those at bar. In the Central R. Co. case the taxpayer received property in settlement of a suit brought by it against an unfaithful officer who violated his fiduciary duty to it and thereby deprived the railroad of revenues. A kind of resulting or constructive trust was imposed upon the fruits of his fraud in favor of the railroad company. Nevertheless this court considered the railroad's gain to be a "windfall", not derived either wholly or in part from taxpayer's capital or labor and therefore not income at all within the definition of Eisner v. Macomber.

The decision was followed by the Board of Tax Appeals in Highland Farms Corporation, *supra*, where punitive damages were allowed for slander of title to land. The Board of Tax Appeals refused to treat these punitive damages as income, relying also on the test of taxable income set out in Eisner v. Macomber.

The taxpayers also assert considerations which are based on the general philosophy of income taxation but we will not discuss these specifically in this opinion. But the United States for its part contends that Eisner v. Macomber does not settle the applicable definition of what constitutes taxable income insofar as the cases at bar are concerned, that the decision of this court in the Central R. Co. case is not applicable, but if it is, it was wrongly decided, and that the decision of the Board of Tax Appeals in Highland Farms was clearly erroneous. The substance of the government's argument is that all property or money coming into the hands of a taxpayer is income except where specifically exempted by the taxing statute.

In Eisner v. Macomber the Supreme Court stated: " 'Income may be defined as a gain derived from capital, from labor or from
62 both combined,' provided it be understood to include profit gained through sale or conversion of capital assets . . ." In Eisner v. Macomber the Supreme Court laid emphasis on the ordinary meaning of income in common parlance and said, 252 U. S. at pp. 206-207: "For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment . . ." The second sentence of the applicable Treasury Regulations adopted the Eisner v. Macomber definition *in toto*. See note 7 of this opinion. The only qualification of the second sentence of the regulation lies in the phrase "In general" and surely little can be taken from that. Of course, as the United States points out, in Eisner v. Macomber the Supreme Court was primarily concerned with distinguishing between capital and income, not between sources of property which came into the hands of the taxpayer and we cannot doubt but that the Supreme Court has departed in some degree from the Eisner v. Macomber definition. This is apparent from United States v. Kirby

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[7] Treasury Regulations 111, in pertinent part provide:

"Sec. 29.22(a)-1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits and income derived from any source whatever, unless exempt from tax by law. (See section 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. . . ."

Lumber Co.,[8] 284 U. S. 1, 3 (1931) where Mr. Justices Holmes stated: "We see nothing to be gained by the discussion of judicial definitions."

If the property or money paid represents a return of capital or a contribution to capital it is not subject to income taxation. Subsidies paid by a sovereign to aid in the construction and operation of a railroad line were held not to be income in Edwards v. Cuba R. R. Co., 268 U. S. 628 (1925) and the money and property acquired were treated in effect as an accretion to capital. But compare Detroit Edison Company v. Commissioner, 319 U. S. 98 (1943) where the Supreme Court has indicated some halt in the doctrine of capital donation expressed in Edwards v. Cuba R. R. Co., 63 *supra*. Cf. also Great Northern Ry. Co. v. Commissioner, 8 B. T. A. 225 (1927), aff'd. 40 F. 2d 372 (8 Cir. 1930). A single gift of money or property probably should not be treated as taxable income even if the specific exemption granted to gifts by statute were unavailable. Periodicity seems to be considered a factor. See Irwin v. Gavit, 268 U. S. 161, 168 (1925); Magill, *Taxable Income*, *supra*, note 8, at p. 428. The spontaneity of the gift may also serve to relieve the recipient of tax. See Bogardus v. Commissioner, 302 U. S. 34, 42 (1937); Washburn v. Commissioner, 5 T. C. 1333 (1945).[9]

The United States lays emphasis on the decision of the Court of Claims in Park & Tilford Distillers Corp. v. United States, 107 F. Supp. 941, 943-5 (1952). In this case the issue was whether a recovery under Section 16(b) of the Securities Exchange Act, 15 U. S. C. A. § 78 p(b), constituted income to the recovering corporate taxpayer. The Court of Claims held that the recovery was taxable as income and specifically rejected the reasoning of this court in Central R. Co. v. Commissioner and the decision of the Board of Tax Appeals in Highland Farms. The Court of Claims stated: "The money came in from an outside source, it went into the plaintiff's treasury, it did not replace something which went out of plaintiff's ownership as a consideration for it." The Court went

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[8] The lumber company purchased its own bonds in the open market at less than par and the difference in price was held to be taxable as income. It is clear, however, that compensatory damages for loss of income are taxable as income and that income takes its color from source. See Chapter 10 "Compensatory Payments," *Taxable Income*, Magill, Rev. Ed., 1945, at p. 377 *et seq.*

[9] Sums of money won by way of contest awards are taxable. See Robertson v. United States, 343 U. S. 711 (1952). But these cases are readily distinguishable from a mere gift since services are rendered. Lottery prizes are also distinguishable. See Huntington v. Commissioner, 35 B. T. A. 835 (1937).

on to say that it was unwilling to surmise that the definition of "income" of Eisner v. Macomber was sufficient to read out of the taxing statute the phrase "income derived from any source whatever." In our opinion the theory of recovery under Section 16(b) of the Securities Exchange Act of 1934 is not a purely punitive one. The statute was designed to prohibit profit being made by an "insider" possessing peculiar knowledge of future profitable operations of his corporation. The making of a profit by the "insider" is the mainspring of the statute, a profit required by law to be passed on to the corporation probably because the corporation is the most convenient receptacle. An "outsider" purchasing stock in the open market, theoretically at least, would be compelled to pay a higher price because an insider was purchasing stock in the market against him. But, under the operation of the statute, all of the stockholders, save only the "insider" whose operations were prohibited by statute, would receive via the corporate entity the profit made by the prohibited transaction.[10] We do not agree with the position of the Court of Claims that Park & Tilford's recovery was purely a "windfall".

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In General American Investors Company, Inc. v. Commissioner, 19 T. C. 581 (1952), affirmed, — F. 2d — (2d Cir. 1954), the Tax Court followed the Park & Tilford decision of the Court of Claims but distinguished its decision from that in the instant Glenshaw Glass Company case and the decisions in Central R. Co. and Highland Farms employing the definition of taxable income of Eisner v. Macomber. Judge Murdock in his concurring opinion pointed to the provisions of Section 16(b) of the Securities Exchange Act of 1934, viz., that "any profit realized" under the circumstances presented by the General American Investors case "shall inure to and be recoverable by the issuer", i.e., the corporation. Judge Murdock

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[10] The nature of Section 16(b) of the Securities Exchange Act of 1934 is referred to in 66 Harv. L. Rev. at p. 408 as follows:

"We are unaware of any other statute that offers a precise analogy to this subsection. It has within its elements of an ordinary shareholder's derivative suit for damages based upon a breach of fiduciary duty, elements of a statutory action for punitive damages, and elements of an informer's statute. It appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is made liable to the corporation for the profits he realizes. Unlike the 'corporate opportunity' cases, however, the action may be brought even though the insider has not competed with his corporation in the use of the information. The courts have found each of these analogies useful, but none furnishes compelling authority."

took the position that the profits were income to General American Investors within the purview of Section 22(a) of the Internal
65 Revenue Code "since they were 'profits' either from 'sales or dealings in property . . . growing out of the ownership of . . . or interest in such property' or 'from any source whatsoever'."

The facts of the Park and Tilford and the General American Investors decisions are distinguishable both from those at bar and from Central R. Co. v. Commissioner, *supra*.

The United States contends that the "source of gain" should not be controlling in view of the final phrase of Section 22(a) dealing with gains or profits or income "derived from any source whatever"; that the phrase last quoted expresses congressional intent that the source of income or gain is immaterial—a complete negation of the concept of source in relation to taxable income. The government in substance asserts that any money or property coming into the hands of any person is taxable as income unless specifically exempted. But we have found no case in which the court did not look to source as at least coloring or bearing upon the incidence of taxation.

Punitive damages seem to *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear that they do not fall within the definition of Eisner v. Macomber and if we could be certain that the definition of that case was controlling we would have no difficulty with the issue at bar. It is easy to say what punitive damages are not but difficult to say what they really are. They smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo*.

An analogy seems to us to lie in those cases where contribu-
66 tions are made by the sovereign in the general public interest to an individual. Cf. Edwards v. Cuba Railroad Company, *supra*. Where the injuries were gross, the doctrine of punitive damages come into play. The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer.

The Supreme Court has never expressly departed from the definition of income of Eisner v. Macomber. In fact it has reiterated it fairly recently. See Merchants Loan and Trust Company v. Smietanka, 255 U. S. 509, 519 (1921) and Commissioner v. Culbertson,

337 U. S. 733, 740 (1949). And see Helvering v. Griffiths, 318 U. S. 371 (1943) in which the Supreme Court expressly declined to overrule Eisner v. Macomber on the facts there presented. The Culbertsion decision cites not only Treasury Regulations 101, Article 22(a)-1 but also 1 Mertens, Law of Federal Income Taxation, 159 *et seq.* See the authorities set out in note 9 cited to § 5.02 of Mertens. We concede that no definition is too helpful, United States v. Kirby Lumber Co., *supra*, and that the decisions relating to income tax law contain charts rather than definitions, as Mr. Mertens has aptly stated. But it should be borne in mind that in Eisner v. Macomber, albeit where severability was the primary issue, the Supreme Court said, 252 U. S. at pp. 206-207, that "only a clear definition of the term 'income' as used in common speech . . ." was required. We do believe that a "windfall"—and the payments at bar were not "windfalls"—would not be regarded as "income" within the terms of common speech. Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor. We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him. This is perhaps an over-simplification but we are of the opinion that the ordinary man using terms of common speech would
67 not regard punitive damages as "income."

We must further concede that the decision of this court in Central R. Co. v. Commissioner cannot be deemed to be overwhelmingly persuasive for the sources of the moneys in that case can be distinguished from the sources of the moneys sought to be taxed in the instant cases but the decision has been followed frequently and has been applied to the issue of taxation of punitive damages. See Highland Farms, *supra*. There is as yet no decision which has adopted the contentions made by the Government here. The position of the United States would indeed, if adopted, bring symmetry into this aspect of the law of income taxation. See "The Taxability of Punitive Damages," 101 U. of P. L. Rev. 1052 (1953). Cf. Keasbey and Mattison Co. v. Rothensies, 133 F. 2d 894, 897 (3 Cir. 1943). But we think if such a result is to be achieved after nearly two decades it should be effected by the Supreme Court and not by this tribunal.

The decisions of the Tax Court will be affirmed.

68 United States Court of Appeals for the Third Circuit

No. 11,073

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GLENSHAW GLASS COMPANY, Respondent

JUDGMENT—Filed April 9, 1954

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

[File endorsement omitted.]

69 United States Court of Appeals for the Third Circuit

No. 11,150

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

WILLIAM GOLDMAN THEATRES, INC., Respondent

JUDGMENT—Filed April 9, 1954

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

[File endorsement omitted.]

70 United States Court of Appeals for the Third Circuit

[Title omitted]

ORDER

And now, to wit, this 26th day of April, 1954,

It is ordered that the opinion filed herein on April 9, 1954 be and the same hereby is amended by striking the word "not" from the 30th line of the 8th page thereof.

By the Court,

BIGGS

*Chief Judge.*

71-72 MANDATES OMITTED IN PRINTING

73-74 Clerk's Certificate to foregoing transcript omitted in printing.

75 Supreme Court of the United States, October Term, 1954

No. 199

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed October 14, 1954

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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# In the Supreme Court of the United States

OCTOBER TERM, 1954

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No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY

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No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC.

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*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgments of the Court of Appeals for the Third Circuit in the above-entitled cases, which involve the same basic question and, although entirely separate proceedings, were argued together before the court below.[1]

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[1] See Rule 23 (5). The *Glenshaw Glass Co.* case was briefed and set for oral argument in the court below before

### OPINIONS BELOW

The opinion of the Court of Appeals (App. 33a–44a) is reported at 211 F. 2d 928. The findings of fact and opinion of the Tax Court in the *Glenshaw Glass Co.* case (App. 1a–23a) are reported at 18 T. C. 860. The findings of fact and opinion of the Tax Court in the *William Goldman Theatres* case (App. 23a–32a) are reported at 19 T. C. 637.

### JURISDICTION

These cases involve deficiencies in income tax and originated in the Tax Court by the filing of petitions for review pursuant to Section 272 (a) (1) of the Internal Revenue Code (26 U. S. C. 272). The judgments of the Court of Appeals were entered on April 9, 1954 (App. 45a–46a). The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

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the *William Goldman Theatres* case was briefed. When counsel in the *William Goldman Theatres* case filed a petition for leave to file an *amicus curiae* brief in the *Glenshaw Glass Co.* case, the court below denied the petition but ordered that the two cases be listed for argument on the same day before the court *en banc*. For the purposes of this petition we shall cite the portion of *Glenshaw Glass Co.* record printed as an appendix in the court below and filed with this court as "Gl." and the *William Goldman Theatres* appendix as "Go." The opinions of the Tax Court in each case, the order of the court below referred to above, the opinion of the court below covering both cases, and the judgment entered by the court below in each case are printed as an appendix to this petition, *infra*, pages 1a–46a, which we shall cite as "App."

## QUESTION PRESENTED

Each taxpayer received compensatory and punitive damages as the result of litigation in which it claimed injury to its business on the basis of lost profits. The question in each case is whether the amount received as punitive damages constitutes taxable income.

## STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> (26 U. S. C. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.22 (a)–1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in prop-

> erty, interest, rent, dividends, and gain, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

## STATEMENT

In a single opinion the court below affirmed the holding of the Tax Court in each of these two cases that punitive damages do not constitute taxable income. The facts relating to the receipt of the punitive damages by each taxpayer are reflected in findings of fact of the Tax Court (App. 2a–14a, 24a–26a) which are largely based upon stipulations of fact and may be summarized as follows:[2]

### GLENSHAW GLASS CO.

The taxpayer (hereinafter usually referred to as "Glenshaw"), a Pennsylvania corporation having its principal place of business in Glenshaw, Pennsylvania, has been continuously engaged in the manufacture of glass bottles and glass containers. Many years ago it entered into certain

[2] In the *Glenshaw Glass Co.* case the Tax Court's findings of fact are based upon a stipulation of facts (Gl. 3a–12a) and oral testimony and exhibits, but the oral testimony had a bearing primarily on an allocation question as to which the Commissioner did not appeal. In the *William Goldman Theatres* case the facts are all stipulated. (Go. 3a–7a.)

royalty and license agreements with the Hartford Empire Company (App. 2a). As a result of fraudulent suits brought by Hartford with respect to these agreements, Glenshaw asserted claims against Hartford in two proceedings seeking damages for injuries to its business, treble damages under the antitrust laws, and punitive damages (App. 6a, 7a). Before one of these proceedings had reached trial and while the other was on appeal, a settlement was reached, both suits were terminated, and Hartford paid Glenshaw a total of $813,358.24 (App. 12a). The taxpayer allocated $324,529.94 of this settlement to punitive damages and did not include it and other portions of the settlement as income in its tax return for the year during which it was received. The Commissioner determined a deficiency in the amount of $126,361.66 (App. 1a) on the ground that the entire amount of the settlement sum constituted taxable income, against which legal fees of $225,000 are deductible.[3]

The Tax Court held that the total amount of the settlement sum received as compensatory damages was taxable income as having been received on the basis of claims for lost profits, rather than for lost capital (App. 19a), but that the amount received as punitive damages by virtue of those claims for lost profits did not constitute taxable

[3] The grounds for the Commissioner's deficiency determination are reflected in the deficiency notice, which was attached to Exhibit A to Glenshaw's petition in the Tax Court but has not been included in the printed record.

income (App. 16a). The Tax Court also accepted Glenshaw's allocation of the settlement sum (App. 20a), with the result that $324,529.94 of that sum was held to be excludible from Glenshaw's taxable income as constituting punitive damages.[4] On appeal by the Commissioner the Court of Appeals affirmed the Tax Court's holding that punitive damages do not constitute taxable income.[5]

WILLIAM GOLDMAN THEATRES

The taxpayer (hereinafter usually referred to as "Goldman") is a Delaware corporation having its principal place of business in Philadelphia, Pennsylvania. During 1948 its business consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations (App. 24a).

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[4] With respect to the deductibility of $225,000 in legal fees incurred in the litigation and settlement of the claims against Hartford, the parties agreed in the Tax Court that the fees should be allocated between the various claimed items of damages in the same proportion as the settlement proceeds are allocated, that the amount of fees allocated to the claims that gave rise to taxable income is deductible as an ordinary and necessary business expense, and that the amount of fees allocated to the claims that did not give rise to taxable income is not deductible. (App. 22a.)

[5] On appeal we did not question the correctness of the Tax Court's allocation of the settlement sum as between compensatory and puitive damages except to the extent that the allocation is unnecessary under our contention that the punitive damages constituted taxable income.

On December 8, 1942, Goldman instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania (Civil Action No. 2877) against certain motion picture distributors, alleging violation of the federal anti-trust laws and seeking treble damages of $1,350,000 based on an allegation that, as a result of the discrimination which the defendants accomplished through the alleged monopoly, Goldman suffered damage in the amount of $450,000 by being unable to operate its Erlanger Theatre. The District Court entered judgment for the defendants (*William Goldman Theatres* v. *Loew's, Inc.*, 54 F. Supp. 1011) but on appeal the Court of Appeals held that a conspiracy existed as charged and reversed the judgment (150 F. 2d 738 (C. A. 3d)). Thereafter the District Court heard evidence directed solely to the question of damages. On September 10, 1946, it made its findings with respect to damages, finding that Goldman had suffered damages by way of a loss of profits at its Erlanger Theatre in the amount of $125,000 and was entitled to treble damages in the amount of $375,000 (69 F. Supp. 103). On December 18, 1946, the District Court entered judgment based on its findings. On appeal the judgment was affirmed on January 6, 1948, in a *per curiam* opinion (164 F. 2d 1021 (C. A. 3d), and certiorari was denied, 334 U. S. 811 (App. 26a).

On May 28, 1948, the defendants paid Goldman the $375,000 judgment award. Goldman included only $125,000 in its gross income for 1948 (App. 26a) and the Commissioner accordingly determined a deficiency against Goldman for 1948 based upon the inclusion of the other two-thirds in Goldman's gross income (App. 23a, 27a). The Tax Court held that the other two-thirds ($250,000) constituted punitive damages which are not taxable income (App. 31a), and the Court of Appeals affirmed (App. 46a).

## REASONS FOR GRANTING THE WRIT

These cases present an important question which should be decided by this Court, namely, whether punitive damages, either for fraud or for violation of the antitrust laws, constitute taxable income to the recipient within the meaning of Section 22 (a) of the Internal Revenue Code. Obviously, the question is a recurring one and, since the courts of appeals, the Court of Claims, and the Tax Court have adopted different interpretations of the decisions of this Court, the question is one that only this Court can finally settle.

Under the Sixteenth Amendment Congress has power to tax, without apportionment, income "from whatever source derived * * *." The statutory definition of gross income in Section 22 (a) of the Internal Revenue Code includes "gains or profits and income derived from any source whatever."

The same language is repeated in Section 29.22 (a)–1 of Treasury Regulation 111. However, the court below read the broad language of these provisions as modified by *Eisner* v. *Macomber*, 252 U. S. 189, 207, where this Court used as a definition of income "gain derived from capital, from labor, or from both combined." This definition has recently been referred to and repeated by this Court in *Commissioner* v. *Culbertson*, 337 U. S. 733, 740.

There is a disagreement in the lower courts on whether the definition in *Eisner* v. *Macomber* limits the meaning of "gross income" in the statute for all purposes, or was merely intended in the context in which it was used to determine whether there was a realization of gain. The court below found support for its position in its earlier decision in *Central R. Co.* v. *Commissioner*, 79 F. 2d 697. Although that case did not involve the narrow question of punitive damages, but instead the "windfall" accruing to a corporation when it took over, as part of a settlement, assets which had been acquired by an unfaithful officer, it was made applicable to punitive damages for business injury by the Board of Tax Appeals in *Highland Farms Corp.* v. *Commissioner*, 42 B. T. A. 1314, 1322.[6]

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[6] In its *Glenshaw Glass Co.* decision, the Tax Court stated that "it has long been established" that punitive damages do not meet the test of taxable income set forth in *Eisner* v. *Macomber*, citing its *Highland Farms Corp.* decision and the

A contrary interpretation of *Eisner* v. *Macomber* appears in *Park & Tilford Distillers Corp.* v. *United States,* 107 F. Supp. 941 (C. Cls.), certiorari denied, 345 U. S. 917. In that case an officer-director of the taxpayer-corporation owning more than 10 percent of the stock of the corporation had purchased and sold stock of the corporation on the open market within a six-month period and realized what are called "insider profits." Under Section 16 (b) of the Securities Exchange Act of 1934, c. 404, 48 Stat. 881, he was required to turn over to the corporation his profits from the sales and upon demand by the corporation did so. As to the officer-

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decision of the court below in *Central R. Co.* (App. 16a). In its *William Goldman Theatres* decision the Tax Court stated that "Until such time as the *Glenshaw Glass Co.*, the *Central R. Co.*, and the *Highland Farms* cases are overruled, or until Congress by legislation requires that punitive damages be taxable as income, we must follow the established decisions." (App. 31a.)

However, there is little, if any, basis for considering the *Central R. Co.* and *Highland Farms Corp.* decisions as representing a long-standing rule that punitive damages do not constitute taxable income. While these two decisions are relatively old, their rationale was inconsistent from the outset with other decisions. Moreover, the Commissioner's published nonacquiescence in the Tax Court's holding in *Highland Farms Corp.* (1941–1 Cum. Bull. 5) served notice that the holding was not being accepted by the Treasury. Not until the instant cases was there again any attack in the courts on the Commissioner's position that punitive damages constitute taxable income. Now that the attack has been made, however, there are other cases in which the question has been raised, as we show in the text.

director, the payment to the corporation constituted a penalty. See *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (C. A. 2d), certiorari denied, 320 U. S. 751; *Davis* v. *Commissioner*, 17 T. C. 549. The question was whether the payment constituted taxable income to the taxpayer-corporation. In holding that it did, the Court of Claims regarded the payment as a "penalty" to the payor and a "windfall" to the recipient-corporation and held that it "could not rationally be suggested that Congress lacks the power to tax windfalls as income" (107 F. Supp. at 943), that the payment was "income derived from any source whatever" under Section 22 (a) of the Code (p. 942), that it saw "no reason for not giving the statutory language its natural meaning" (p. 942), that "If Congress were to select one kind of receipt of money which, above all others, would be a fair mark for taxation, it might well be 'windfalls' " (p. 942), that it was "unwilling to surmise" that by the *Eisner* v. *Macomber* definition this Court intended to read "income derived from any source whatever" out of Section 22 (a) (p. 943), that the fact that the payment was a penalty to the payor had no bearing on the question of taxability to the recipient (p. 944), and that "Cases such as *Central R. Co. of New Jersey* v. *Commissioner*, 3 Cir., 79 F. 2d 697, and *Highland Farms Corporation*, 42 B. T. A. 1314, 1319, which seem to rest only upon the definition of income given

by the Supreme Court in *Eisner* v. *Macomber*, do not seem to us persuasive" (p. 945).[7]

More recently the Court of Appeals for the Second Circuit in *General American Investors Company* v. *Commissioner*, 211 F. 2d 522, in which a petition for certiorari is now pending, No. 114, followed the lead taken by the Court of Claims in *Park & Tilford* in another case arising with respect to profits turned over to a corporation pursuant to Section 16 (b) of the Securities Exchange Act of 1934. The taxpayer-corporation there also "relie[d] principally" upon the *Eisner* v. *Macomber* definition of income, which the court stated did not cover the payments involved "If this definition is to be regarded as all inclusive, and to be applied literally" (p. 523). In answering the taxpayer's argument, the court stated that the *Eisner* v. *Macomber* definition "has met the common fate of generalities" (p. 523), that "it will not help to characterize these payments as a 'windfall' to the corporation or as in the nature

[7] On petition for a writ of certiorari in the *Park & Tilford Distillers Corp.* case the taxpayer alleged a conflict with the decision of the court below in *Central R. Co.* In the Brief in Opposition, No. 544, October Term, 1952, it was stated that the Government believed the *Central R. Co. case* "was incorrectly decided," that "its reasoning, which turns on the dictum of *Eisner* v. *Macomber*, no longer has vitality in the law," and that "Regardless, therefore, of whether its facts are distinguishable from those in the case at bar, we believe that the alleged conflict does not require resolution by this Court." (Pp. 10–11.) The decision below gives renewed vitality to the *Central R. Co.* decision.

of a 'penalty' imposed upon the director and the stockholder" (p. 524), and that "if we consider the words 'gains or profits and income derived from any source,' 'in their plain popular meaning,' as we think they should be, how can there be any doubt that these Section 16 (b) payments are 'income'?" (p. 524).[8]

Moreover, this Court has not considered the *Eisner* v. *Macomber* definition of income as limiting the taxability of gains according to their source. In a number of decisions the Court has quoted the Section 22 (a) definition of gross income as including "gains or profits and income derived from any source whatever" and held certain gains to come within that clause which are not covered by the *Eisner* v. *Macomber* definition. See, e. g., *Rutkin* v. *United States*, 343 U. S. 130; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Helvering* v. *Bruun*, 309 U. S. 461; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *United States*

[8] The court below regarded the *Park & Tilford Distillers Corp.* and *General American Inv. Co.* decisions as distinguishable from the present cases (App. 41a), stating, among other things, that it did not agree with the Court of Claims in the *Park & Tilford Distillers Corp.* case that the recovery there was purely a windfall (App. 40a). The distinction drawn by the court below between those cases and the instant cases seems to be that under the statute involved in those cases the profits were required to be passed on, and inured, to the corporation. But as the Second Circuit stated in its *General American Inv. Co.* decision, such reasoning "will not bear analysis," for the "payments were not 'profits' to petitioner, although they represented 'profits' realized by the director and the stockholder." (P. 524.)

v. *Kirby Lumber Co.*, 284 U. S. 1; *Taft* v. *Bowers*, 278 U. S. 470; *Cooper* v. *United States*, 280 U. S. 409. For example, the *Rutkin* case, *supra*, involved the question whether money obtained by extortion constitutes taxable income. The extorted money ($250,000) not only was not derived by the taxpayer-extortioner from capital or labor or both combined but was money the receipt of which was unlawful. The Court concluded, however, that Section 22 (a) "reaches these receipts," stating that the power of Congress to tax the receipts "is unquestionable" and that the broad language of Section 22 (a) "supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income" (pp. 138–139). In the *Safety Car Heating Company* case a sum received in settlement of a suit for profits lost by reason of the infringement of a patent was considered income, and in *Helvering* v. *Bruun* the gain realized by the taxpayer from the erection of a building on his property was very much in the nature of a "windfall."

Even in its narrow aspect, as limited to punitive damages, the issue in this case is a recurring one. There are now pending at least four cases in which it is involved. *Obear-Nester Glass Co.* v. *Commissioner*, 20 T. C. 1102, now pending on appeal to the Seventh Circuit; *Telefilm, Inc.* v. *Commissioner*, 21 T. C. No. 77; *Maurice W. Kinzel, Trustee in Liquidation for Theatre Investment Co.* v. *United States* (W. D. Wash.),

Civil No. 3650; *Maurice W. Kinzel, Trustee in Liquidation for Venetian Theatre Co.* v. *United States* (W. D. Wash.), Civil No. 3651. Since the receipt of punitive damages is by no means unusual, other cases will undoubtedly arise in the near future. In its broader aspect, that is, whether the statutory definition of income is to be limited by the source of the gain, the issue arises with even greater frequency. Review of the present cases is necessary in order to obviate the confusion and expense in the administration of the revenue laws incident to further litigation of the question.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted.

SIMON E. SOBELOFF,
*Solicitor General.*

JULY 1954.

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# APPENDIX

# APPENDIX

## The Tax Court of the United States

### OPINION

GLENSHAW GLASS COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[18 T. C. 860]

Docket No. 30821. Promulgated August 13, 1952

1. Where a lump sum of money is received in settlement of various claims, an allocation of specific amounts to each of the several claims is necessary and proper.

2. Sums received in settlement of punitive damages do not constitute taxable income.

3. Sums received in settlement of claims for anticipated profits are taxable as ordinary income.

*Sidney B. Gambill, Esq.*, for the petitioner.

*Albert J. O'Connor, Esq.*, for the respondent.

The respondent has determined deficiencies of $31.82 and $126,361.06 in the petitioner's income tax liability for the taxable years ending September 30, 1947, and September 30, 1948, respectively.

The petitioner contests the deficiency determined for the taxable year 1948 which results from the inclusion as ordinary income of the proceeds received in a compromise settlement of various claims.

All stipulated facts are found as stipulated.

*Findings of fact*

The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the taxable year 1948 the petitioner's income tax return was filed with the collector of internal revenue for the twenty-third district of Pennsylvania.

For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license agreements were without restrictions as to the type of glass containers that could be manufactured by the petitioner.

Early in 1923, Hartford-Empire Company (hereinafter referred to as Hartford) representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles,

and certain other items. Each Hartford license agreement contained a provision permitting its termination by petitioner upon the payment of a prescribed lump sum minimum royalty. From 1923 until 1931, petitioner used and operated only glass feeding machines under the Hartford license agreements, and pursuant to such agreements petitioner paid royalties to Hartford from 1923 through the fiscal year ended September 30, 1931.

The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July 1931, and a 5-year exclusive distribution contract for the sale of its entire fruit jar output was executed with a distributor in September of that year. In December 1932 the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

In 1931 and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During that period, Haub developed and built in peti-

tioner's plant a new feeder known as the Shawkee feeder. Petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. By October 19, 1934, the date of the permanent injunction hereinafter referred to, petitioner had seven royalty-free Shawkee feeders in operation in its plant and was manufacturing 65 per cent of its total production on these machines. It had by then replaced five Howard (Hartford licensed) feeders. The Shawkee feeder proved to be an efficient, workable feeder, equal to those covered by the Hartford licenses.

On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Shawkee Manufacturing Co., et al.,* Docket No. 2791. On the basis of an earlier decision, in *Hartford-Empire Co.* v. *Hazel-Atlas Glass Co.,* 59 F. 2d 399, the complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner.

Relying upon its earlier decision in the *Hazel-Atlas* case, the Circuit Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction, with an opinion reported at 68 F. 2d 726. Pursuant to the mandate of the Circuit Court, the United States District Court for the Western District of Pennsylvania

entered an order for a permanent injunction on October 19, 1934. The permanent injunction enjoined the use of Shawkee feeders by petitioner for the manufacture of any and all glassware, and ordered an accounting. Upon the entry of the permanent injunction, the royalty-free Shawkee feeders were dismantled by petitioner. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Hartford licensed feeders and to pay royalties. Were it not for the permanent injunction, the petitioner would have continued to install royalty-free Shawkee feeders to replace the Hartford licensed feeders.

The accounting directed by the permanent injunction was finally concluded by a settlement between the parties in 1939, whereby petitioner paid Hartford the sum of $11,167.85. A final decree in Docket No. 2791 was thereupon entered in 1939.

In 1939, the United States instituted a civil action in the United States District Court for the Northern District of Ohio, in which Hartford was ultimately held to have violated the Federal antitrust laws. *United States* v. *Hartford-Empire Co.*, 46 F. Supp. 541. The judgment of the District Court finding and holding that Hartford had violated the antitrust laws was affirmed by the United States Supreme Court. *Hartford-Empire Co.* v. *United States*, 323 U. S. 386; 324 U. S. 570.

After December 1940, petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision resulted from information disclosed in the antitrust proceedings prosecuted against Hartford by the United States.

Hartford thereupon filed an action for royalties against petitioner in 1941 in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Glenshaw Glass Co.*, Civil Action No. 1650. Following the disclosures made in the Government's antitrust case, the petitioner filed an answer and counterclaim asking for a return of certain royalties and treble damages for destruction of certain lines of its business in violation of the antitrust laws. Hartford's motion to strike the petitioner's counterclaim on the ground that it stated no cause of action was denied in 1942. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

Also, following the disclosures in the Government's antitrust case, petitioner instituted proceedings to reopen and set aside the permanent injunction entered against it in 1934 in Docket No. 2791. Petitioner charged that the judgment which Hartford had obtained against Hazel-Atlas Glass Company had been secured through fraud, and that the Hazel-Atlas judgment was fraudulently employed to secure the permanent injunction against petitioner in 1934. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing, and the applications to vacate the judgments were denied by the Circuit Court of Appeals for the Third Circuit, by a divided court. On appeal, the Supreme Court of the United States in 1944 ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the ground

of fraud. The Supreme Court ordered that the fraudulently obtained injunction entered against the petitioner in 1934 be annulled and set aside, that Hartford's complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Docket No. 2791, seeking compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount, based upon the findings of fraud made by the Supreme Court. The District Court denied all of the petitioner's claims for damages except the claim for $11,167.85 paid by petitioner to Hartford in 1939, in settlement of the accounting order above referred to.

The District Court found as a fact that on or about June 6, 1939, the petitioner paid $11,167.85 to Hartford in settlement of the accounting ordered by the District Court in 1934; that royalties paid by the petitioner to Hartford between January 1, 1934, and October 1944 aggregated $397,199.42; that subsequent to the beginning of suit, the petitioner expended $21,850.47 in litigation and travel expenses; that the expenses incurred by the petitioner in dismantling the Shawkee feeders totaled $11,920.15. The District Court made no specific finding of fact with respect to the amount of the loss on the fruit jar business.

The evidence relative to the damage claimed for destruction of the fruit jar business was directed toward a showing of lost profits. Testi-

mony and exhibits were introduced to support the estimate of the profits lost during the period beginning 1934 and ending in 1940, the year in which Hartford's license restrictions on the manufacture of glass jars were removed.

Both petitioner and Hartford appealed to the United States Circuit Court of Appeals for the Third Circuit from the judgment entered by the District Court. In the Circuit Court, petitioner pressed its demands for the following items and amounts of damages, all of which claims were opposed by Hartford:

| Item | Amount | Interest at 6 percent to Jan. 1, 1947 | Total |
|---|---|---|---|
| Settlement of accounting order | $11,167.85 | $5,074.22 | $16,242.07 |
| Reimbursement of royalties paid to Hartford after Jan. 1, 1934 ($397,199.42–$26,283.33) [1] | 370,916.09 | 189,085.55 | 560,001.64 |
| Litigation and travel expenses | 21,850.47 | 2,872.50 | 24,722.25 |
| Loss on dismantling Shawkee feeders | 11,920.15 | 8,727.50 | 20,647.65 |
| Loss on destruction of fruit jar business | 292,500.00 | 162,373.54 | 454,873.54 |
| Total | 708,354.56 | 368,133.31 | 1,076,487.15 |
| Punitive damages (in an amount equal to the total amount of restitution and compensatory damages) | | | |

[1] This $26,283.33 item is not involved in the present proceeding.

In the brief submitted on its appeal from the District Court's judgment entered in 1946, the petitioner stated that "Recovery was sought in the counterclaim for the loss of the fruit jar business and reasonably anticipated profits." In a memorandum to the petitioner dated October 1, 1948, counsel for the petitioner in both suits against Hartford stated that in Civil Action No. 1650, "The principal items of damage were (i) injury to business by limitations and exclusions from various fields (ii) loss of profits and (iii) royalty and other expenses."

The Circuit Court of Appeals, on August 14, 1947, filed its opinion and held as follows:

(a) Settlement of accounting order. The judgment of the District Court allowing petitioner's claim in the amount of $11,167.85, with interest at 6 percent, was affirmed.

(b) Royalties. Petitioner's claim for royalties, plus interest, was upheld. However, the court stated that "There may be elements which might possibly affect the amounts of royalties to be refunded and we express no opinion as to this." The case was remanded for the taking of additional testimony, and a determination by the District Court of the specific amounts of royalties to be refunded.

(c) Litigation and travel expenses. Petitioner's claim was upheld.

(d) Dismantling Shawkee feeders. Petitioner's claim was upheld.

(e) Destruction of fruit jar business. The finding of the District Court that the evidence as to this loss was too speculative was affirmed as having "substantial justification" in the record.

(f) Punitive damages. The Court said that "This case calls for such damages although it is for the District Court, as the trier of fact, to assess them, taking into consideration the whole wretched scheme as ascertained and etched in unmistakable terms by the Supreme Court." The Court further stated that the trial court could be governed by "the enormity of [the] offense rather than the measure of compensation."

Hartford had earned large profits as a result of its fraudulent practices.

Both Hartford and the petitioner filed petitions for rehearing with the Circuit Court of Appeals and Hartford filed "comments" upon the petitioner's petition for rehearing. Hartford's petition for rehearing argued for complete freedom from liability under all of petitioner's claims. The petition filed by petitioner sought to persuade the Court to direct the entry of a judgment for the full amount of the royalties it had paid, plus interest. Petitioner also asserted that the Court's ruling denying recovery for the destruction of the fruit jar business rested on errors of law, as well as fact, and disregarded controlling decisions of the United States Supreme Court. In reply, Hartford continued to assert its position that it was entitled to substantial credits against the royalties to be refunded to petitioner. The petitions for rehearing were denied by the Circuit Court of Appeals on October 1, 1947.

While the petitions for rehearing were pending, settlement discussions between petitioner and Hartford were commenced. Petitioner's executive officers and counsel had agreed among themselves to ask for $1,530,000, consisting of the following items:

| | | |
|---|---|---|
| Accounting settlement; litigation and travel expenses; dismantling Shawkee feeders | | $45,000 |
| Reimbursement of royalties paid to Hartford | | 370,000 |
| Loss on destruction of fruit jar business | | 250,000 |
| Punitive damages in Docket No. 2791 | | 500,000 |
| Civil Action No. 1650 (antitrust suit): | | |
| Loss on destruction of lines of glassware other than fruit jar business | $55,000 | |
| Punitive damages | 110,000 | |
| | | 165,000 |
| Interest on refund of royalties and other reimbursement items | | 200,000 |
| | | 1,530,000 |

Petitioner's counsel, in Civil Action No. 1650 and Docket No. 2791, was convinced and so advised the petitioner's president at the time negotiations for settlement began and at the time Hartford's final offer in settlement was received that upon remand of Docket No. 2791 to the District Court, the petitioner would probably receive punitive damages of approximately $500,000 to $750,000 and possibly $1,000,000 or $1,500,000; and, further, that if the District Court awarded as punitive damages a sum of $250,000 or less, it would very likely be reversed upon appeal to the Circuit Court of Appeals. Counsel was of the view that such a large award would be made in view of such factors as the Circuit Court of Appeals' scathing denunciation of the fraud practiced by Hartford, the large profits it earned during the years the fraud was practiced, and the Circuit Court of Appeals' statement that the District Court, in assessing the punitive damages, could be governed by the enormity of the offense rather than the measure of compensation. The claims for punitive damages under Civil Action No. 1650 and Docket No. 2791 were serious claims, and figured prominently in the final settlement.

The $250,000 claim for loss on the fruit jar business was included in the total sum of $1,530,000 asked by the petitioner in settlement, mainly for bargaining purposes. Since the claim was disallowed by the District Court and the disallowance was affirmed on appeal, the petitioner was prepared to abandon it immediately. Throughout the negotiation proceedings, the representatives of Hartford took the position that

the question of the allowance of that claim had been resolved by litigation and they would, therefore, pay no attention to it.

The claim for compensatory and punitive damages under Civil Action No. 1650 (antitrust suit) in the amount of $165,000 consisted of $55,000 as the value placed on the claims for destruction of lines of glassware business other than the fruit jar line, and $110,000 as the value assigned to the punitive damages claim. The claims for destruction of the fruit jar line and for return of royalties had also been alleged in Civil Action No. 1650.

The itemized proposal was communicated to representatives of Hartford at a meeting in September 1947. Hartford expressed a willingness to pay a sum in the area of $200,000 but any discussion of settlement in that range was declined. Thereafter, in October 1947, Hartford made a lump sum settlement offer of $600,000 to petitioner, which was rejected. In November 1947 Hartford offered the lump sum of $813,358.24. This offer was accepted by petitioner, and the settlement agreement was executed on December 15, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court.

The settlement terminated the litigation in Civil Action No. 1650 and Docket No. 2791, referred to above, and was evidenced by a settlement agreement and two mutual releases. Pursuant to the settlement agreement, Hartford paid petitioner the sum of $813,358.24 on December 23, 1947. No agreement was made by the parties to the settlement as to the allocation of

that amount among the various claims involved in the litigation and settlement negotiations.

In the fiscal year ended September 30, 1948, petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

In its income tax return for the taxable year 1948, the petitioner reported the total proceeds of $813,358.24 from which it deducted $225,000 for attorney fees, leaving a balance of $588,358.24 as the net proceeds. This balance was allocated to the various claims by according to each claim that proportion of the net settlement proceeds ($588,358.24) which the value give to such claim (under the breakdown given to Hartford in the original settlement offer of $1,530,000) bears to the total value of $1,530,000 assigned to all claims. The computation was as follows:

| | Value under $1,530,000 offer | Percentage of total value of $1,530,000 assigned to all claims | Allocated net proceeds of $588,358.24 |
|---|---|---|---|
| Settlement of accounting order litigation and travel expenses, dismantling Shawkee feeders | $45,000 | [1] 2.9 | $17,062.39 |
| Reimbursement of royalties paid to Hartford | 370,000 | [1] 24.2 | 142,382.69 |
| Loss on destruction of fruit jar business | 250,000 | [2] 16.3 | 95,902.40 |
| Punitive damages in Docket No. 2791 | 500,000 | [2] 32.7 | 192,393.14 |
| Civil Action No. 1650 (antitrust suit): | | | |
| Loss on destruction of lines of glassware business other than fruit jar business | 55,000 | [2] 3.6 | 21,180.90 |
| Punitive damages | 110,000 | [2] 7.2 | 42,361.79 |
| Interest | 200,000 | [1] 13.1 | 77,074.93 |
| Total | 1,530,000 | 100.0 | 588,358.24 |

[1] On the schedule attached to the income tax return, these three items were combined at a total percentage of 40.20, and a total sum of $236,520.01.

[2] On the schedule attached to the income tax return, these four items were combined at a total percentage of 59.80, and a total sum of $351,838.23. The two items under Civil Action No. 1650 (antitrust suit) were totaled at $165,000 and referred to as "Damage to Business Covered by Antitrust suit." No part of the $165,000 sum was referred to as punitive damages.

The net effect of the computation was to allocate to each claim an amount equal to approximately 38.45 percent ($588,358.24÷$1,530,000) of the amount assigned to it in the breakdown of the original settlement offered to Hartford.

The sum of $813,358.24 received as a lump sum settlement of all claims that petitioner had against Hartford should be apportioned among the several claims in the ratio that this sum bears to the total sum of $1,530,000 claimed in the petitioner's original settlement offer.

The $225,000 in legal fees incurred by the petitioner in the litigation and settlement of the claims against Hartford should be allocated between the claims in the same proportion as the $813,358.24 received in settlement is allocated to the several claims. The fees allocated to the claims that give rise to taxable income constitute an ordinary and necessary business expense.

In its claims for loss due to destruction of the fruit jar and other lines of glassware business, asserted in the lawsuits and in the settlement negotiations that followed, the petitioner sought recovery for loss of anticipated profits and not for lost capital.

*Opinion*

ARUNDELL, *Judge:* The basic issue before us is the taxability of a sum of money received by the petitioner in 1947 in compromise settlement of several claims asserted against Hartford-Empire Company (hereinafter referred to as Hartford) in two suits and in subsequent settlement negotiations. The claims were for: (1) reimbursement of the sum paid in settlement of the accounting

order; (2) reimbursement of litigation and travel expenses; (3) reimbursement of loss incurred in dismantling Shawkee feeders; (4) reimbursement of royalties paid to Hartford; (5) interest on refund of royalties and other reimbursement items; (6) loss due to destruction of fruit jar business; (7) loss due to destruction of various lines of glassware business other than the fruit jar business; (8) punitive damages under section 4 of the Clayton Act (15 U. S. C. A., Title 15, section 15) for violation of Federal antitrust laws resulting in destruction of various lines of glassware business other than the fruit jar business, and (9) punitive damages for loss caused by Hartford's fraudulent practices.

The taxable nature of the sum received in settlement of each of those claims is dependent upon the nature of the claim. That is, a sum received in settlement of a claim for a nontaxable item is nontaxable whereas it would be taxable as ordinary income if the item claimed was an ordinary income item, or taxable as a return of capital if the claim was for recovery of lost capital. *Raytheon Production Corporation* v. *Commissioner,* 144 F. 2d 110, certiorari denied 322 U. S. 777; *Durkee* v. *Commissioner,* 162 F. 2d 184, and cases cited therein.

The parties seem to be in agreement that the sums received in settlement of the first five claims are taxable as ordinary income. The respondent has determined that they constitute ordinary income, and petitioner has offered no evidence or argument to the contrary.

The first issue is whether the sums received in settlement of the punitive damages claims consti-

tute taxable income. It has long been established that punitive damages do not meet the test of taxable income set forth in *Eisner* v. *Macomber,* 252 U. S. 189, 207, as "'* * * the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets * * *." *Central R. Co.* v. *Commissioner,* 79 F. 2d 697; *Highland Farms Corporation,* 42 B. T. A. 1314. This basic definition has been recently cited with complete approval in *Commissioner* v. *Culbertson,* 337 U. S. 733, 740, and has been adhered to by the respondent in his Regulations 111, section 29.22 (a)–1. Therefore, on the authority of those cases, we follow this rule of long standing that has never been questioned in any court and hold that the sums received in settlement of the punitive damages claims do not constitute taxable income.

The taxability of the sums received in settlement of the claims for loss due to destruction of the fruit jar and other lines of glassware business is in issue because the parties disagree as to what the taxpayer sought to recover. The petitioner contends it sought recovery of lost capital only, and the respondent contends that recovery for the loss of anticipated profits was sought. Whether or not the sums received in settlement of those claims are taxable as a return of capital or as ordinary income is dependent upon the resolution of this question of fact. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn,* 186 F. 2d 450; *Mathey* v. *Commissioner,* 177 F. 2d 259, affirming 10 T. C. 1099.

The petitioner, in support of its contention that it sought to recover only lost capital, relies on the fact that in these claims the destruction of the business was alleged. However, destruction of a business is a factual premise that might support a claim based on the loss of anticipated profits as well as the loss of capital. We must, therefore, look further to determine what the petitioner sought to recover.

The pleadings in both suits Nos. 1791 and 1650 fail to refer to any asset, either tangible or intangible, that was damaged or destroyed. There is no allegation that any physical assets became idle or useless because of the prohibition against the manufacture of certain lines of glassware but, on the contrary, we know that the same machinery used to manufacture the prohibited glassware was also used to manufacture other unprohibited lines of glassware. Intangibles such as "good will" or "reputation" are nowhere mentioned and there is no contention that with reference to the prohibited lines of glassware business the petitioner had acquired "good will" or that sums had been expended and capitalized in the development of those lines. *Martin Brothers Box Co.* v. *Commissioner,* 142 F. 2d 457.

No evidence was introduced in the litigated suit or in this proceeding to establish at least that there had been in existence an asset, later destroyed, that could conceivably have been the basis of a claim for lost capital. The petitioner offered no evidence of customers' lists, schedule of valuable established merchandise outlets for those wares, testimony of preference given to those wares by consumers, or similar evidence likely

to be introduced where loss of good will or a similar asset is in issue. In fact, the evidence establishes that the petitioner's fruit jar business was not begun until July 1931 and, further, that in September of that year the petitioner gave to a distributor a 5-year exclusive distribution contract for the sale of its entire fruit jar output.

The evidence in the litigated suit consisted mainly of a showing of loss of anticipated profits. Testimony and exhibits were introduced to support an estimate of the profits that would have been earned during the period beginning 1934 and ending with the removal in 1940 of the prohibitions against the manufacture of fruit jars. The significance of the petitioner's reliance on such evidence is not lessened because evidence of past profits actually earned is sometimes introduced to value good will. See *Raytheon Production Corporation* v. *Commissioner, supra.* It is very unlikely that the petitioner attempted to prove the value of good will by estimated anticipated profits. In any event, such a purpose cannot be inferred when there is no reference to good will or any similar asset that might need to be valued. Finally, we must note that the Circuit Court of Appeals for the Third Circuit characterized that claim as a "claim for loss of profits." *Hartford-Empire Co.* v. *Shawkee Mfg. Co.,* 163 F. 2d 474, 479.

After carefully studying this and all other evidence, especially the exhibits and testimony pertinent to suits Nos. 2791 and 1650, and subsequent discussions between Hartford and the petitioner, we find the posture of the litigation and settlement negotiations to be such that on the record

before us we cannot find that the recovery sought was for lost capital but, on the contrary, find that recovery was sought for the loss of anticipated profits. Therefore, the sums received in settlement of those claims represented recovery for the loss of anticipated profits and are taxable as ordinary income. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn, supra; Mathey* v. *Commissioner, supra.*

However, even if the evidence established that the petitioner sought recovery only in part for loss of anticipated profits, the entire proceeds would represent a recovery for the loss of anticipated profits. The respondent has in effect determined that none of the settlement proceeds represented a return of capital, and the petitioner has relied entirely on the proposition that recovery was solely for lost capital and that the proceeds received in settlement represent a return of capital. The petitioner therefore made no attempt to, and the record does not contain any evidence on the basis of which we could, apportion the settlement proceeds between recovery of lost capital and recovery for loss of anticipated profits. Under such circumstances, the entire sum received in settlement of those claims represents a recovery for loss of anticipated profits and is taxable as ordinary income. *Armstrong Knitting Mills,* 19 B. T. A. 32; *Arcadia Refining Co.* v. *Commissioner,* 118 F. 2d 1010; *H. Liebes & Co.* v. *Commissioner,* 90 F. 2d 932; *Martin Brothers Box Co.* v. *Commissioner, supra.*

Finally, we must determine what portion of the $813,358.24 settlement proceeds is allocable to the

punitive damages claims and how much is allocable to the remaining claims which give rise to taxable income. Since the entire sum allocable to the remaining claims is taxable as ordinary income, it is not necessary that we determine what portion is allocable to each individual item in that category.

The parties to the compromise settlement merely agreed to a lump sum payment and made no attempt to decide how much was paid and received in settlement of each claim or how much was attributable to the punitive damages claims. Under those circumstances, an allocation is necessary and proper. *Specialty Engineering Co.*, 12 T. C. 1173; cf. *Cramp Shipbuilding Co.*, 17 T. C. 516; see *Helvering* v. *Safe Deposit & Trust Co.*, 316 U. S. 56.

The petitioner proposes that we allocate to the punitive damages claims that proportion of the gross settlement proceeds ($813,358.24) which the value assigned to those claims by the petitioner at the beginning of settlement negotiations bears to the total value ($1,530,000) assigned to all claims at that time. Pursuant to that proposal, petitioner allocated $324,529.94 to the punitive damages claims and the balance to the remaining claims.

We accept the general method of allocation proposed by the petitioner as a reasonable one which in our opinion is fair to the respondent, and in so doing we are not unmindful of the respondent's objection that this method ignores the relative weight possessed by those various claims. However, we do not deem this material

since the respondent does not suffer from the allocation as proposed. The failure to take into account relative weight did not increase, and possibly decreased, the amount of the settlement proceeds allocated to the punitive damages claims. For example, by giving equal weight to the claim for destruction of the fruit jar business, admittedly the weakest claim, the amount allocated to ordinary income was proportionately increased and the amount allocated to the punitive damages claims was proportionately decreased.

Furthermore, not only did the claims for punitive damages possess more weight than the claim for destruction of the fruit jar business but, in addition, we think they possessed at least approximately the same weight as all other claims, other than the first three relatively small claims totaling $44,938.47 and the interest thereon.

The claims for punitive damages, especially the claim in No. 2791, were serious claims that undoubtedly figured prominently in the settlement negotiations and final settlement agreement. In No. 1350, the petitioner pressed a claim for treble damages under section 4 of the Clayton Act. Hartford had already been found guilty of violating Federal antitrust laws and the judgment was affirmed by the United States Supreme Court. In No. 2791, the Circuit Court of Appeals for the Third Circuit ruled that the petitioner should receive punitive damages and prepared the way for a large award by scathingly denouncing the fraud of which the petitioner had been a victim, and by stating that "In those circumstances, the trial court has power to inflict such

damages, 'having in view the enormity of * * * [the] offense rather than the measure of compensation * * *.'" Hartford had earned large profits as a result of those fraudulent practices.

The sum of $813,358.24 received as a lump settlement will be apportioned in the manner set forth in our findings and the tax thereon will be computed as we have determined herein.

The parties have agreed that the legal fees incurred in the litigation and settlement of the several claims against Hartford should be allocated between the claims in the same proportion as the settlement proceeds are allocated. They further agreed that the fees allocated to the claims that gave rise to taxable income are deductible as an ordinary and necessary business expense, and that the fees allocated to the claims that did not give rise to taxable income are not deductible.

*Decision will be entered under Rule 50.*

*Decision*

[Caption omitted]

Pursuant to the Opinion of the Court promulgated August 13, 1952, the respondent herein, on December 1, 1952, filed a recomputation for entry of decision, the petitioner's acquiescence in the respondent's recomputation being noted thereon. Wherefore, it is

Ordered and decided that there is no deficiency in income tax for the taxable year ended September 30, 1948, and that there is an overpayment in income tax for the taxable year ended September 30, 1948, in the amount of $85,709.20, all of

which was paid after the mailing of the notice of deficiency.

Entered: Dec. 3, 1952.

(Signed) ERNEST H. VAN FOSSAN,
*Judge.*

Findings of Fact and Opinion of the Tax Court

WILLIAM GOLDMAN THEATRES, INC., PETITIONER
*v.*
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[19 T. C. 637]

Docket No. 29450. Promulgated January 9, 1953

*Income—Punitive Damages.*—Petitioner, as an injured party, received a damage judgment in an antitrust suit. *Held,* one-third of the award was compensatory damages for loss of profits and taxable as income. *Held, further,* that two-thirds of the award was punitive damages and not taxable.

*Samuel H. Levy, Esq.,* and *Bernard Wolfman, Esq.,* for the petitioner.

*Jules I. Whitman, Esq.,* for the respondent.

The respondent determined deficiencies in petitioner's income tax for the years 1947 and 1948 in the amounts of $1,847.19 and $92,874.70, respectively. The deficiency determined for the year 1947 is not in issue.

Two of the three allegations of error for the year 1948 were resolved by stipulation of the parties. The sole remaining issue before us is whether a two-thirds portion of the aggregate award received by petitioner in an antitrust suit was taxable income.

*Firdings of fact*

The facts are stipulated and are so found.

The petitioner is a Delaware corporation authorized to do business in the Commonwealth of Pennsylvania and has its principal place of business at Philadelphia, Pennsylvania. Petitioner's income tax return for 1948 was filed with the collector of internal revenue for the district of Pennsylvania.

Petitioner's business during the year 1948 consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations. On December 8, 1942, petitioner instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania against certain motion picture distributors; petitioner alleged that the named defendants violated the Federal antitrust laws. The action was brought under section 4 of the Act of Congress of October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies and for other purposes," as amended and supplemented (15 U. S. C. A. 15), commonly known as the Clayton Act, and sections 1 and 2 of the Act of Congress of July 2, 1890, entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (15 U. S. C. A. 1), said Act being commonly known as the Sherman Anti-Trust Act, and the Act of Congress of June 19, 1936 (15 U. S. C. A. 13), commonly known as the Robinson-Patman Act. Petitioner's complaint was in part as follows:

28. As a result of the discrimination against plaintiff which defendants accomplished through said monopoly, plaintiff has been unable to operate the Erlanger Theatre and has thereby suffered great loss and damage, to wit, the sum of $450,000.00.

Wherefore, plaintiff prays:

* * * * *

(e) That the defendants be decreed to pay to the plaintiff triple all such damages as may have been sustained by the plaintiff as above, to wit, the sum of $1,350,000.00.

After the case was presented to the district court a judgment was entered in favor of the defendants. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 54 F. Supp. 1011.

On appeal the United States Court of Appeals for the Third Circuit reversed the judgment of the district court; the Court of Appeals held that a conspiracy existed as charged. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 150 F. 2d 738. Pursuant to an agreement of the parties and pending the court's decision on the question of liability under the Sherman Act, William Goldman Theatres, Inc., offered no evidence relating to the issue of damages at the first stage of the trial. After the Court of Appeals held the evidence sufficient to sustain the charge of conspiracy in restraint of trade the district court heard evidence directed solely to the question of damages.

On September 10, 1946, the district court made its findings with respect to damages. The damages were based solely on the petitioner's loss of profits at the Erlanger Theatre. The court's findings is a follows:

> I, therefore, find as a fact that the plaintiff, but for the wrongful acts of the defendants, would have earned profits at the Erianger Theatre amounting to $125,000 during the damage period.

*William Goldman Theatres, Inc.* v. *Loew's Inc.*, 69 F. Supp. 103.

On December 18, 1946, the district court entered a final decree based on the findings as set forth in the opinion of September 10, 1946. Paragraph four of the opinion provides:

> The amount of the plaintiff's damages is $125,000 and the defendant shall pay to the plaintiff threefold that amount, or $375,000. Interest to date is not allowed.

On January 6, 1948, the Court of Appeals for the Third Circuit affirmed the judgment of the district court in a *per curiam* opinion. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 164 F. 2d 1021. Certiorari was denied by the United States Supreme Court, 334 U. S. 811.

On May 28, 1948, the defendants paid the petitioner the sum of $375,000. Of this amount petitioner, on its income tax return for the year 1948, included in gross income the amount of $125,000. The balance of the $375,000 was not included in petitioner's gross income for the year 1948.

Of the aggregate award of $375,000, petitioner received $250,000 as punitive damages and $125,000 for the loss of profits.

*Opinion*

JOHNSON, *Judge:* Petitioner has reported as taxable income $125,000 of a total $375,000 judg-

ment received upon the successful prosecution of an antitrust suit. The award was made under what is commonly known as section 4 of the Clayton Act (15 U. S. C. A. 15).[1]

Respondent maintains that the excess ($250,000) by which the award exceeds the actual damages ($125,000) constitutes taxable income under section 22 (a) of the Internal Revenue Code and the Sixteenth Amendment. Respondent also contends that the entire award in this case was for loss of profits and therefore the entire amount is taxable. Petitioner, in opposition, relies on the contention that the sum of $250,000 constitutes a penalty which is not income and therefore is not taxable.

Two questions must be answered before we ascertain the correctness of respondent's contention. First, we must determine for what purpose the $250,000 was awarded. Was it received in lieu of profits or capital gain, or was it received as a punitive award under the Clayton Act? Next, if the money were received as a punitive award, is it taxable income?

The district court did not specifically denominate this $250,000 as a particular type of damage; that court, however, did find as a fact that peti-

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[1] "§ 15. Suits by persons injured; amount of recovery.

"Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. Oct. 15, 1914, c. 323, § 4, 38 Stat. 731."

tioner's damages from loss of profits amounted to $125,000 and under the statute (Clayton Act) it was entitled to threefold the damages sustained. This decision of the district court does not resolve the issue before us; therefore we must look elsewhere.

The words of the Clayton Act, "and shall recover threefold the damages by him sustained," do not in themselves answer our question; we have, therefore, gone into the legislative history of the Sherman Act (section 7, 26 Stat. 210), and the Clayton Act. We have found that even though Congress did not set forth in the statute the words "punitive" or "exemplary" in describing part of the threefold damages, there can be no doubt that Congress intended part of the threefold damages to be compensatory and part to be punitive.[2]

The courts have also interpreted the award in antitrust suits to be composed of both punitive and compensatory damages. The court in *Clark Oil Co.* v. *Phillips Petroleum Co.*, 148 F. 2d 580, 582, said:

> * * * The Sherman Act and the Clayton Act afford a cause of action for those suffering damages. In their provisions for damages they embody both punitive and compensatory damages but no recovery can be had unless a case for compensatory damages is made. In the event of compensatory damages, then automatically the punitive damages follow. * * *

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[2] See Bills and Debates in Congress Relating to Trusts, 1903, S. Doc. No. 147, 57th Cong., 2d Sess.; the History of Bills and Resolutions, 51 Cong. Rec. Index 160, H. R. 15657, 63d Cong., 2d Sess.

Again, it was said in *Johnson* v. *Schlitz Brewing Co.*, 33 F. Supp. 176, 182, affirmed, 123 F. 2d 1016, that section 7 of the Sherman Act "was intended to be punitive in nature and deterrent in effect." Further, in *Bigelow* v. *RKO Radio Pictures, Inc.*, 150 F. 2d 877, 883, reversed on other grounds, 327 U. S. 251, it was said:

> * * * The amount of this verdict [under 15 U. S. C. A. 15] was required by statute to be trebled by the judgment. In this respect neither the jury nor either court had any discretion. The verdict should represent actual damages sustained, and two-thirds of the judgment is a penalty which Congress has seen fit to impose in such cases upon a guilty defendant. * * *

In other instances the courts have been required to determine whether the threefold damages for antitrust violations were penal in the strict and primary sense in that they were redresses for injuries to the public rather than redresses for wrongs to individuals. In these cases the courts held that the treble damages are either exemplary damages or penalties. *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 232 F. 574, 577; *City of Atlanta* v. *Chattanooga Foundry & Pipeworks*, 127 F. 23, 28, affirmed, 203 U. S. 390.

We have found no case which held that the excess over the actual damages, when the excess was severable from the actual damages, was anything but a penalty, punitive or exemplary damages. Cf. *Durkee* v. *Commissioner*, 181 F. 2d 189, affirming a Memorandum Opinion of this Court; *Durkee* v. *Commissioner*, 162 F. 2d 184,

reversing 6 T. C. 773; *Mathey* v. *Commissioner,* 177 F. 2d 259, affirming, 10 T. C. 1099. We shall not attempt to distinguish between punitive or exemplary damages. For our purposes they shall be considered the same. See 15A Words and Phrases 341. It is proper for us to conclude that the part of the award which represents loss of profits is compensatory in that it makes the injured petitioner whole. Likewise that part of the award in excess of compensation is punitive damages. Of the statutory threefold damages, we conclude that one part is compensatory and two parts are punitive; therefore the $250,000 was awarded as punitive damages.

Following the determination that part of the award is a penalty, we must next ascertain whether it is taxable income. The question of whether penalties are taxable is not new or novel. In a recent decision involving a settlement under an antitrust suit, we held that those sums apportioned to penalties were not taxable as income. *Glenshaw Glass Co.,* 18 T. C. 860. In an earlier case, *Highland Farms Corporation,* 42 B. T. A. 1314, a jury awarded the taxpayer damages for slander of title to its property and for interference with its business, and in addition awarded a sum as exemplary damages. We held that the exemplary damages were not taxable income. On p. 1322 we said: "A penalty imposed by law does not meet the test of taxable income set forth in *Eisner* v. *Macomber,* 252 U. S. 189, as 'the gain derived from capital, from labor, or both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets."

See also, *Central R. Co. of New Jersey* v. *Commissioner*, 79 F. 2d 697, where it was held that a penalty imposed by law upon a faithless fiduciary was not taxable income.

Respondent would have us hold that these cited cases are no longer authority to be followed in holding that punitive damages are not taxable income. Respondent has cited a great many cases in support of his contention but has failed to show that punitive damages are taxable as income. Until such time as the *Glenshaw Glass Co.*, the *Central R. Co.*, and the *Highland Farms* cases are overruled, or until Congress by legislation requires that punitive damages be taxable as income, we must follow the established decisions. We think that *General American Investors Co.*, 19 T. C. 581, is distinguished from our present case. In that case the taxpayer did not receive the money in payment of punitive damages, but pursuant to a statute which provided that certain profits realized by corporate insiders under circumstances there present should "inure to and be recoverable by" the corporation.

We conclude, therefore, that the petitioner shall be sustained as to the $250,000, but the other adjustments in the deficiency notice shall require a Rule 50 computation.

*Decision will be entered under Rule 50.*

*Decision*

[Caption omitted]

Pursuant to Opinion of the Tax Court in the above-entitled proceeding promulgated January

9, 1953, respondent filed a computation on March 18, 1953, in which petitioner concurred. Now, therefore, it is

Ordered and decided that there is a deficiency in income tax for the calendar year 1948 in the amount of $523.74.

(Signed) O. P. LeMire,
*Judge.*

Enter: Entered Mar. 25, 1953.

In the United States Court of Appeals for the Third Circuit

No. 11073

Commissioner of Internal Revenue, petitioner

*v.*

Glenshaw Glass Company, respondent

(Received and filed August 17, 1953. Ida O. Creskoff, clerk.)

Present: Biggs, *Chief Judge,* and Maris, Kalodner and Hastie, *Circuit Judges*

*Order*

Upon consideration of the petition of William Goldman Theatres, Inc., for leave to file brief as amicus curiae in the above entitled case, in which it is alleged that the decision in the above entitled case is likely to be determinative of the issue involved in *William Goldman Theatres, Inc.* v. *Commissioner of Internal Revenue,* Tax Court Docket No. 29450, 19 T. C. No. 79, before hearing may be had in the latter case;

It is ordered that the Clerk of this Court list the above entitled case and the case of *William Goldman Theatres, Inc.* v. *Commissioner of Internal Revenue, Petitioner,* for argument on the same day before the Court en banc;

It is further ordered that the petition for leave to file brief as amicus curiae in the above-entitled case be and it hereby is denied.

By the Court:

BIGGS,
*Chief Judge.*

AUGUST 17th 1953.

United States Court of Appeals for the Third Circuit

No. 11073

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY, RESPONDENT

No. 11150

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC., RESPONDENT

[211 F. 2d 928]

APPEALS FROM THE TAX COURT OF THE UNITED STATES

Argued December 23, 1953

Before BIGGS, *Chief Judge,* and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

*Opinion of the Court*

(Filed April 9, 1954)

By BIGGS, *Chief Judge.*

The Commissioner seeks to reverse two decisions of the United States Tax Court in favor of two taxpayers. In Glenshaw a claim for punitive damages based upon a competitor's, Hartford's, fraudulent suits which disastrously affected the taxpayer's business, as well as a claim for treble damages under Section 4 of the Clayton Act, 15 U. S. C. A. § 15, were settled by

the payment of a sum of money.[1] In Goldman a judgment for treble damages was awarded Goldman against Loew's, Inc.,[2] also pursuant to Section 4 of the Clayton Act. The sole question presented for our determination is whether moneys paid as punitive or statutory treble damages are taxable as income under Section 22 (a) of the Internal Revenue Code,[3] 26 U. S. C. A. The Tax Court has decided that they are not and the Commissioner of Internal Revenue has petitioned this court for review.[4] Insofar as the issue before us

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[1] For the history of the litigation see: *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 F. 2d 474 (3 Cir. 1947); *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 67 F. Supp. 26 (D. C. W. D. Pa. 1946); *Hartford-Empire Co.* v. *United States*, 323 U. S. 386 (1945); *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 147 F. 2d 532 (3 Cir. 1944); *Shawkee Mfg. Co.* v. *Hartford-Empire Co.*, 322 U. S. 271 (1944), reversing *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 137 F. 2d 764 (3 Cir. 1943); *Shawkee Mfg. Co.* v. *Hartford-Empire Co.*, 68 F. 2d 726 (3 Cir. 1934); and *Hartford-Empire Co.* v. *Hazel-Atlas Glass Co.*, 59 F. 2d 399 (3 Cir. 1932).

[2] See *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 164 F. 2d 1021 (3 Cir. 1948).

[3] Section 22 (a) of the Internal Revenue Code, in pertinent part, is as follows:

"*General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

[4] The Tax Court opinions are reported at 18 T. C. 860 (Glenshaw) and 19 T. C. 637 (Goldman). See also *Ohear Nester Glass Co.*, 20 T. C. No. 152, and *Telefilm, Inc.*, 21 T. C. —, similar cases.

is concerned no valid distinctions can be drawn between a money settlement and money paid in satisfaction of a judgment or between punitive damages levied for fraud and treble damages rendered under the Clayton Act.[5]

The positions of the taxpayers are based in large part upon the definition of "income" set out in *Eisner* v. *Macomber,* 252 U. S. 189, 207 (1920), on the decision of this court in *Central R. Co.* v. *Commissioner,* 79 F. 2d 697 (3 Cir., 1935), the decision of the Board of Tax Appeals in *Highland Farms Corporation* v. *Commissioner of Internal Revenue,* 42 B. T. A. 1314 (1940), and the applicable Treasury Regulations.[6] [7] The taxpayers

[5] The Commissioner and Glenshaw do not now dispute that $324,529.94 was the amount paid in settlement of punitive damages. In the *Goldman* case the amount of actual damage, found to be $125,000, was trebled and a judgment was entered for $375,000. We are concerned solely with the taxability of the sum of $324,529.94 (Glenshaw) and the taxability of $250,000 (Goldman).

[6] The facts of the *Central R. Co.* case are distinguishable from those at bar. In the *Central R. Co.* case the taxpayer received property in settlement of a suit brought by it against an unfaithful officer who violated his fiduciary duty to it and thereby deprived the railroad of revenues. A kind of resulting or constructive trust was imposed upon the fruits of his fraud in favor of the railroad company. Nevertheless this court considered the railroad's gain to be a "windfall," not derived either wholly or in part from the taxpayer's capital or labor and therefore not income at all within the definition of *Eisner* v. *Macomber.*

The decision was followed by the Board of Tax Appeals in *Highland Farms Corporation, supra,* where punitive damages were allowed for slander of title to land. The Board of Tax Appeals refused to treat these punitive damages as income, relying also on the test of taxable income set out in *Eisner* v. *Macomber.*

[7] Treasury Regulations 111, in pertinent part provide:

"SEC. 29.22 (a)–1. *What Included in Gross Income.*—

also assert considerations which are based on the general philosophy of income taxation but we will not discuss these specifically in this opinion. But the United States for its part contends that *Eisner* v. *Macomber* does not settle the applicable definition of what constitutes taxable income insofar as the cases at bar are concerned, that the decision of this court in the *Central R. Co.* case is not applicable, but if it is, it was wrongly decided, and that the decision of the Board of Tax Appeals in *Highland Farms* was clearly erroneous. The substance of the government's argument is that all property or money coming into the hands of a taxpayer is income except where specifically exempted by the taxing statute.

In *Eisner* v. *Macomber* the Supreme Court stated: " 'Income may be defined as a gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets * * *." In *Eisner* v. *Macomber* the Supreme Court laid emphasis on the ordinary meaning of income in common parlance and said, 252 U. S. at pp. 206–207: "For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment * * *." The second sentence of the

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Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See section 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets * * *."

applicable Treasury Regulations adopted the *Eisner* v. *Macomber* definition *in toto*. See note 7 of this opinion. The only qualification of the second sentence of the regulation lies in the phrase "In general" and surely little can be taken from that. Of course, as the United States points out, in *Eisner* v. *Macomber* the Supreme Court was primarily concerned with distinguishing between capital and income, not between sources of property which came into the hands of the taxpayer and we cannot doubt but that the Supreme Court has departed in some degree from the *Eisner* v. *Macomber* definition. This is apparent from *United States* v. *Kirby Lumber Co.*,[8] 284 U. S. 1, 3 (1931) where Mr. Justice Holmes stated: "We see nothing to be gained by the discussion of judicial definitions."

If the property or money paid represents a return of capital or a contribution to capital it is not subject to income taxation. Subsidies paid by a sovereign to aid in the construction and operation of a railroad line were held not to be income in *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628 (1925) and the money and property acquired were treated in effect as an accretion to capital. But compare *Detroit Edison Company* v. *Commissioner*, 319 U. S. 98 (1943) where the Supreme Court has indicated some halt in the doctrine of

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[8] The lumber company purchased its own bonds in the open market at less than par and the difference in price was held to be taxable as income. It is clear, however, that compensatory damages for loss of income are taxable as income and that income takes its color from source. See Chapter 10 "Compensatory Payments," *Taxable Income*, Magill, Rev. Ed., 1945, at p. 377 *et seq.*

capital donation expressed in *Edwards* v. *Cuba R. R. Co., supra.* Cf. also *Great Northern Ry. Co.* v. *Commissioner,* 8 B. T. A. 225 (1927), affirmed, 40 F. 2d 372 (8 Cir. 1930). A single gift of money or property probably should not be treated as taxable income even if the specific exemption granted to gifts by statute were unavailable. Periodicity seems to be considered a factor. See *Irwin* v. *Gavit,* 268 U. S. 161, 168 (1925); Magill, *Taxable Income, supra,* note 8, at p. 423. The spontaneity of the gift may also serve to relieve the recipient of tax. See *Bogardus* v. *Commissioner,* 302 U. S. 34, 42 (1937); *Washburn* v. *Commissioner,* 5 T. C. 1333 (1945).[9]

The United States lays emphasis on the decision of the Court of Claims in *Park & Tilford Distillers Corp.* v. *United States,* 107 F. Supp. 941, 943–5 (1952). In this case the issue was whether a recovery under Section 16 (b) of the Securities Exchange Act, 15 U. S. C. A. § 78p (b), constituted income to the recovering corporate taxpayer. The Court of Claims held that the recovery was taxable as income and specifically rejected the reasoning of this court in *Central R. Co.* v. *Commissioner* and the decision of the Board of Tax Appeals in *Highland Farms.* The Court of Claims stated: "The money came in from an outside source, it went into the plaintiff's treasury, it did not replace something which went out of

[9] Sums of money won by way of contest awards are taxable. See *Robertson* v. *United States,* 343 U. S. 711 (1952). But these cases are readily distinguishable from a mere gift since services are rendered. Lottery prizes are also distinguishable. See *Huntington* v. *Commissioner,* 35 B. T. A. 835 (1937).

plaintiff's ownership as a consideration for it." The Court went on to say that it was unwilling to surmise that the definition of "income" of *Eisner* v. *Macomber* was sufficient to read out of the taxing statute the phrase "income derived from any source whatever." In our opinion the theory of recovery under Section 16 (b) of the Securities Exchange Act of 1934 is not a purely punitive one. The statute was designed to prohibit profit being made by an "insider" possessing peculiar knowledge of future profitable operations of his corporation. The making of a profit by the "insider" is the mainspring of the statute, a profit required by law to be passed on to the corporation probably because the corporation is the most convenient receptacle. An "outsider" purchasing stock in the open market, theoretically at least, would be compelled to pay a higher price because an insider was purchasing stock in the market against him. But, under the operation of the statute, all of the stockholders, save only the "insider" whose operations were prohibited by statute, would receive via the corporate entity the profit made by the prohibited transaction.[10]

[10] The nature of Section 16 (b) of the Securities Exchange Act of 1934 is referred to in 66 Harv. L. Rev. at p. 408 as follows:

"We are unaware of any other statute that offers a precise analogy to this subsection. It has within it elements of an ordinary shareholder's derivative suit for damages based upon a breach of fiduciary duty, elements of a statutory action for punitive damages, and elements of an informer's statute. It appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is

We do not agree with the position of the Court of the Claims that Park & Tilford's recovery was purely a "windfall".

In *General American Investors Company, Inc.* v. *Commissioner*, 19 T. C. 581 (1952), affirmed, 211 F. 2d 522 (2d Cir. 1954), the Tax Court followed the Park & Tilford decision of the Court of Claims but distinguished its decision from that in the instant *Glenshaw Glass Company* case and the decisions in *Central R. Co.* and *Highland Farms* employing the definition of taxable income of *Eisner* v. *Macomber*. Judge Murdock in his concurring opinion pointed to the provisions of Section 16 (b) of the Securities Exchange Act of 1934, viz, that "any profit realized" under the circumstances presented by the *General American Investors* case "shall inure to and be recoverable by the issuer", i. e., the corporation. Judge Murdock took the position that the profits were income to General American Investors within the purview of Section 22 (a) of the Internal Revenue Code "since they were 'profits' either from 'sales or dealings in property * * * growing out of the ownership of * * * or interest in such property' or 'from any source whatsoever'."

The facts of the Park and Tilford and the General American Investors decisions are distinguishable both from those at bar and from *Central R. Co.* v. *Commissioner, supra.*

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made liable to the corporation for the profits he realizes. Unlike the 'corporate opportunity' cases, however, the action may be brought even though the insider has not competed with his corporation in the use of the information. The courts have found each of these analogies useful, but none furnishes compelling authority."

The United States contends that the "source of gain" should not be controlling in view of the final phrase of Section 22 (a) dealing with gains or profits or income "derived from any source whatever"; that the phrase last quoted expresses congressional intent that the source of income or gain is immaterial—a complete negation of the concept of source in relation to taxable income. The government in substance asserts that any money or property coming into the hands of any person is taxable as income unless specifically exempted. But we have found no case in which the court did not look to source as at least coloring or bearing upon the incidence of taxation.

Punitive damages seem to be *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear that they do not fall within the definition of *Eisner* v. *Macomber* and if we could be certain that the definition of that case was controlling we would have no difficulty with the issue at bar. It is easy to say what punitive damages are not but difficult to say what they really are. They smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo*. An analogy seems to us to be in those cases where contributions are made by the sovereign in the general public interest to an individual. Cf.

*Edwards* v. *Cuba Railroad Company, supra.* Where the injuries were gross, the doctrine of punitive damages comes into play. The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer.

The Supreme Court has never expressly departed from the definition of income of *Eisner* v. *Macomber.* In fact it has reiterated it fairly recently. See *Merchants Loan and Trust Company* v. *Smietanka,* 255 U. S. 509, 519 (1921) and *Commissioner* v. *Culbertson,* 337 U. S. 733, 740 (1949). And see *Helvering* v. *Griffiths,* 318 U. S. 371 (1943) in which the Supreme Court expressly declined to overrule *Eisner* v. *Macomber* on the facts there presented. The *Culbertson* decision cites not only Treasury Regulation 101, Article 22 (a)–1 but also 1 Mertens, Law of Federal Income Taxation, 159 *et seq.* See the authorities set out in note 9 cited to § 5.02 of Mertens. We concede that no definition is too helpful, *United States* v. *Kirby Lumber Co., supra,* and that the decisions relating to income tax law contain charts rather than definitions, as Mr. Mertens has aptly stated. But it should be borne in mind that in *Eisner* v. *Macomber,* albeit where severability was the primary issue, the Supreme Court said, 252 U. S. at pp. 206–207, that "only a clear definition of the term 'income' as used in common speech * * *" was required. We do believe that a "windfall"—and

the payments at bar were "windfalls"—would not be regarded as "income" within the terms of common speech. Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor. We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him. This is perhaps an over-simplification but we are of the opinion that the ordinary man using terms of common speech would not regard punitive damages as "income."

We must further concede that the decision of this court in *Central R. Co.* v. *Commissioner* cannot be deemed to be overwhelmingly persuasive for the sources of the moneys in that case can be distinguished from the sources of the moneys sought to be taxed in the instant cases but the decision has been followed frequently and has been applied to the issue of taxation of punitive damages. See *Highland Farms, supra.* There is as yet no decision which has adopted the contentions made by the Government here. The position of the United States would indeed, if adopted, bring symmetry into this aspect of the law of income taxation. See "The Taxability of Punitive Damages," 101 U. of P. L. Rev. 1052 (1953). Cf. *Keasbey and Mattison Co.* v. *Rothensies,* 133 F. 2d 894, 897 (3 Cir. 1943). But we think if such a result is to be achieved after nearly two decades it should be effected by the Supreme Court and not by this tribunal.

The decisions of the Tax Court will be affirmed.

In the United States Court of Appeals
for the Third Circuit

No. 11073

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY, RESPONDENT

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: BIGGS, *Chief Judge,* and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

*Judgment*

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF,
*Clerk.*

APRIL 9, 1954.

Received and filed April 9, 1954. Ida O. Creskoff, Clerk.

United States Court of Appeals for the Third Circuit

No. 11150

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC., RESPONDENT

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: BIGGS, *Chief Judge,* and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

*Judgment*

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IDA O. CRESKOFF,
*Clerk.*

APRIL 9, 1954.

Received and filed April 9, 1954. Ida O. Creskoff, Clerk.

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No. 198

# In the Supreme Court of the United States

OCTOBER TERM, 1954

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC.

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE PETITIONER

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# In the Supreme Court of the United States

OCTOBER TERM, 1954

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No. 199

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC.

---

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE PETITIONER

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### OPINIONS BELOW

The opinion of the Court of Appeals (R. 31–37), which covers two separate cases decided by the Tax Court, is reported at 211 F. 2d 928.[1] The findings of fact and opinion of the Tax Court

[1] The *Glenshaw Glass Co.* case was briefed and set for oral argument in the court below before the *William Goldman Theatres* case was briefed. When counsel in the *William Goldman Theatres* case filed a petition for leave to file an *amicus curiae* brief in the *Glenshaw Glass Co.* case, the court below denied the petition but ordered that the two cases be listed for argument on the same day before the court *en banc*.

in the *Glenshaw Glass Co.* case (R. 7–20) are reported at 18 T. C. 860. The findings of fact and opinion of the Tax Court in the *William Goldman Theatres* case (R. 25–30) are reported at 19 T. C. 637.

### JURISDICTION

The judgments of the Court of Appeals were entered on April 9, 1954. (R. 38.) The petition for a writ of certiorari in both cases was filed July 8, 1954, and was granted October 14, 1954 (R. 39). The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

### QUESTION PRESENTED

Each taxpayer received compensatory and punitive damages as the result of litigation in which it claimed injury to its business on the basis of lost profits. The question in each case is whether the amount received as punitive damages constitutes taxable income.

### CONSTITUTIONAL AND STATUTORY PROVISIONS AND REGULATIONS

Constitution of the United States:

> Art. I, Sec. 2, Clause 3:
>
> * * * direct Taxes shall be apportioned among the several States * * * according to their respective Numbers * * *
>
> Art. I, Sec. 8, Clause 1:
>
> The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises * * * but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art. I, Sec. 9, Clause 4:

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census Enumeration herein before directed to be taken.

Sixteenth Amendment:

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.21-1. *Meaning of Net Income.*—The tax imposed by chapter 1 is upon in-

come. * * * In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. * * *

(b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by chapter 1. (See section 22.)

(c) Net income, meaning gross income less statutory deductions. * * *

* * * * *

SEC. 29.22 (a)–1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * *

## STATEMENT

In a single opinion the court below affirmed two Tax Court decisions holding that punitive damages do not constitute taxable income. The facts relating to the receipt of the punitive damages by each taxpayer are reflected in findings of fact of the Tax Court (R. 8–16, 25–27) which are largely based upon stipulations of fact and may be summarized as follows:[2]

### GLENSHAW GLASS COMPANY

The taxpayer (hereinafter usually referred to as "Glenshaw"), a Pennsylvania corporation having its principal place of business in Glenshaw, Pennsylvania, has been continuously engaged in the manufacture of glass bottles and glass containers. Many years ago it was induced by Hartford-Empire Company (hereinafter referred to as "Hartford") to cancel royalty-free license agreements covering feeder machines in its manufacturing operations and to enter into license agreements with Hartford requiring the payment of royalties. When the license agreements expired, Glenshaw began using the Shawkee feeder, royalty-free, which it had developed through another corporation, the Shaw-

[2] In the *Glenshaw Glass Co.* case the Tax Court's findings of fact are based upon a stipulation of facts (R. 2–7) and oral testimony and exhibits, but the oral testimony had a bearing primarily on an allocation question as to which the Commissioner did not appeal. In the *William Goldman Theatres* case the facts are all stipulated. (R. 22–25.)

kee Manufacturing Company. Hartford thereupon filed an injunction suit against Glenshaw charging infringement of its patents and in 1934 successfully enjoined Glenshaw from using the Shawkee feeder. See *Shawkee Mfg. Co.* v. *Hartford-Empire Co.*, 68 F. 2d 726 (C. A. 3d). As a result, Glenshaw was required to replace the Shawkee feeders with Hartford licensed feeders and, in an accounting which followed, was required to pay Hartford $11,167.85. (R. 8–10.)

Some years later, after the United States instituted a civil suit in which Hartford was ultimately held to have violated the federal antitrust laws (*United States* v. *Hartford-Empire Co.*, 46 F. Supp. 541 (N. D. Ohio), affirmed, 323 U. S. 386, 324 U. S. 570), Glenshaw discontinued all further payments of royalties to Hartford and Hartford filed an action for royalties against Glenshaw (*Hartford-Empire Co.* v. *Glenshaw Glass Co.* (W. D. Pa.), Civil Action No. 1650). Following disclosures made in the Government's antitrust case, Glenshaw filed an answer and counterclaim asking for treble damages for injury to its business by reason of the violation of the federal antitrust laws by Hartford. This proceeding never reached the trial stage. (R. 10.)

In addition, following disclosures in the Government's antitrust case, Glenshaw instituted proceedings to reopen and set aside the perma-

nent injunction entered against it in 1934 on the ground of fraud. This Court ultimately ordered that the fraudulently obtained injunction be annulled and set aside and that Glenshaw be permitted to bring appropriate proceedings for restitution and damages. *Shawkee Mfg. Co.* v. *Hartford Co.*, 322 U. S. 271. Glenshaw thereupon filed a counterclaim in the District Court in the original Hartford injunction proceeding seeking compensatory damages in the amount of $1,500,000 and exemplary damages in a like amount based on the findings of fraud by this Court. (R. 10–11.)

After Glenshaw's damages claims in the fraud action had been substantially sustained on appeal (*Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 F. 2d 474 (C. A. 3d)) and while petitions for rehearing by both sides were pending, the parties began settlement negotiations covering both the fraud suit and the pending but unlitigated antitrust case. The settlement negotiations culminated in a settlement under which Hartford paid $813,358.24 to Glenshaw on December 23, 1947. (R. 11–14.)

Glenshaw allocated $324,529.94 of this settlement sum to punitive damages and did not include it and other portions of the settlement sum as income in its tax return for the year during which it was received. (R. 14–15.) The Commissioner determined a deficiency in the amount

of $126,361.06 (R. 8) on the ground that the entire amount of the settlement sum, less deductible legal fees, constituted taxable income.[3]

The Tax Court held that the total amount of the settlement sum received by Glenshaw as compensatory damages was taxable income as consisting of items conceded to constitute taxable income (R. 16) and damages received on the basis of claims for lost profits rather than lost capital (R. 17–19) but that the amount received as punitive damages on the basis of those claims for compensatory damages did not constitute income (R. 16–17). The Tax Court also accepted Glenshaw's allocation of the settlement sum (R. 15, 19–20), with the result that $324,529.94 of that sum was held to be excludible from Glenshaw's taxable income as constituting punitive damages.[4] On appeal by the Commissioner, the Court of Appeals affirmed the Tax Court's holding that

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[3] The grounds for the Commissioner's deficiency determination are reflected in the deficiency notice, which was attached as Exhibit A to Glenshaw's petition in the Tax Court but has not been included in the printed record.

[4] With respect to the deductibility of $225,000 in legal fees incurred in the litigation and settlement of the claims against Hartford, the parties agreed in the Tax Court that the fees should be allocated between the various claimed items of damages in the same proportion as the settlement proceeds are allocated, that the amount of fees allocated to the claims that gave rise to taxable income is deductible as an ordinary and necessary business expense, and that the amount of fees allocated to the claims that did not give rise to taxable income is not deductible.

punitive damages do not constitute taxable income.[5] (R. 31–37.)

WILLIAM GOLDMAN THEATRES

The taxpayer (hereinafter usually referred to as "Goldman") is a Delaware corporation having its principal place of business in Philadelphia, Pennsylvania. During 1948 its business consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations. (R. 25.)

On December 8, 1942, Goldman instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania (Civil Action No. 2877) against certain motion picture distributors, alleging violation of the federal antitrust laws and seeking treble damages totaling $1,350,000. The District Court entered judgment for the defendants (*William Goldman Theatres* v. *Loew's, Inc.*, 54 F. Supp. 1011) but on appeal the Court of Appeals held that a violation existed as charged and reversed the judgment (150 F. 2d 738 (C. A. 3d)). Thereafter, the District Court heard evidence directed solely to the question of damages. On September 10, 1946, it made

[5] On appeal we did not question the correctness of the Tax Court's allocation of the settlement sum as between compensatory and punitive damages except to the extent that the allocation is unnecessary under our contention that the punitive damages constituted taxable income.

its findings with respect to damages, finding that Goldman had suffered damages by way of a loss of profits at its Erlanger Theatre in the amount of $125,000 and was entitled to treble damages totalling $375,000 (69 F. Supp. 103). On December 18, 1946, the District Court entered judgment based on its findings. On appeal the judgment was affirmed on January 6, 1948, in a *per curiam* opinion (164 F. 2d 1021 (C. A. 3d)), and certiorari was denied (334 U. S. 811). (R. 25–27.)

On May 28, 1948, the defendants paid Goldman the $375,000 judgment award. Goldman included only $125,000 in its gross income for 1948 (R. 27) and the Commissioner accordingly determined a deficiency against Goldman for 1948 based upon the inclusion of the other two-thirds in Goldman's gross income (R. 25). The Tax Court held that the other two-thirds ($250,000) constituted punitive damages which are not taxable income (R. 27–30), and the Court of Appeals affirmed (R. 31–37).

## SUMMARY OF ARGUMENT

Congress by Section 22 (a) of the Internal Revenue Code of 1939 taxed "gains * * * from any source whatever". This language, which has been included in the successive income tax laws since 1913, by its terms taxes all gain except such as may be exempt from tax. It is undisputed that payments of punitive damages constitute gain to the recipients as distinguished from return of

capital and are not within the statutory exemption from tax provided for gifts. It follows that they necessarily fall within the scope of Section 22 (a).

Neither the Constitution nor the decisions of this Court limit gain subject to tax so as to exclude receipts on account of punitive damages. Under Article I, Section 8 of the Constitution, Congress always has had the power to tax receipts not derived from property without apportionment. The power of Congress to tax such receipts existed before the Sixteenth Amendment was adopted and was not affected by that Amendment. The sole purpose of the Amendment was to remove the constitutional requirement of apportionment from a tax on income from property (capital), which this Court had held in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, was a direct tax in the constitutional sense, because in substance it imposed a burden on property. The word "gain" in the statute, which is valid under Article I of the Constitution, and not the word "income" in the Sixteenth Amendment, therefore, controls the question whether payments of punitive damages are taxable to the recipient.

The court below, in concluding that gain from punitive damages was not covered by the statute, relied primarily on a definition of income used by this Court to distinguish income from capital in *Eisner* v. *Macomber*, 252 U. S. 189, 207, i. e., that income consists of " 'the gain derived from capital,

from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets". While this definition may be helpful in broadly distinguishing income from capital, it was never intended as a precise, restrictive definition modifying the statutory language which declared all gain subject to tax. This Court has repeatedly held subject to tax gain which could not, at least in any usual sense of the words, be said to be derived by the taxpayer from capital or labor or both. Thus this Court has held subject to tax gain resulting from ~~embezzlement~~ extortion, the settlement of a law suit, the award of a prize, payments received pursuant to a bequest of income from a trust, etc. Following these cases, and rejecting the contention that the *Eisner* v. *Macomber* definition of income restricts the meaning of gain as that word is used in the statute, the Court of Claims and courts of appeals other than the court below have held receipts from statutory penalties subject to tax, and the Court of Appeals for the Seventh Circuit, in a decision directly contrary to that of the court below, has held payments of punitive damages taxable.

The court below seems to have been of the view that there was a long-standing rule that punitive damages do not constitute taxable income. The only case so holding is a 1940 decision of the Tax Court, with respect to which the Commissioner promptly published his non-acquiescence.

## ARGUMENT

### THE PUNITIVE DAMAGES RECEIVED BY TAXPAYERS CONSTITUTED TAXABLE INCOME

Section 22 (a) of the Internal Revenue Code of 1939 defines "gross income" to include "gains or profits and income derived from any source whatever." This language, which has been included in the successive income tax laws since 1913, by its terms taxes all gain except such as may be exempt from tax. The court below recognized that the payments of punitive damages constituted gain to the taxpayers concerned, but held that they were not a type of gain which constitutes taxable income.

The court below rested its conclusion primarily on the proposition that taxable income under the Code was limited by a strict reading of the definition of income used by this Court for the purpose of distinguishing income from capital in *Eisner* v. *Macomber,* 252 U. S. 189, 207—that is, that income consists of " 'the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through the sale or conversion of capital assets." It further thought that as "windfalls" the payments should not be regarded as "income" to the taxpayers, although it recognized that to tax punitive damages would put "symmetry into this aspect of the law of income taxation" (R. 37).

Other courts have rejected, in cases involving payments of statutory penalties, the contention that the definition of income used by this Court in *Eisner* v. *Macomber* limited the scope of income subject to tax under the Code. *Park & Tilford Distillers Corp.* v *United States,* 107 F. Supp. 941 (C. Cls.), certiorari denied, 345 U. S. 917; *General American Inv. Co.* v. *Commissioner,* 211 F. 2d 522 (C. A. 2d), certiorari granted, Oct. 14, 1954, No. 114, this Term. Since the decision of the court below was rendered, the Court of Appeals for the Seventh Circuit in *Commissioner* v. *Obear-Nester Glass Co.,* decided November 15, 1954, now pending on petition for certiorari, No. 478, this Term, held punitive damages like those involved here to constitute taxable income.[6]

Our position is that since payments of punitive damages constitute gain to the recipients which has not been exempted from tax, they constitute taxable income. The statutory language calls for this result and neither the Constitution nor the decisions of this Court warrant any limitation of its plain meaning.

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[6] The decision of the Tax Court in the *Glenshaw case* has been broadly criticized. See *Income Taxation and Treble Damage Antitrust Awards,* 48 Northwestern L. Rev. 85, 90–94 (1953); *The Taxability of Punitive Damages,* 101 U. of Pa. L. Rev. 1052 (1952–1953); *Taxation of Found Property and Other Windfalls,* 20 U. of Chicago L. Rev. 748, 750–753 (1952–1953).

I. SECTION 22 (A) OF THE INTERNAL REVENUE CODE, WHICH DEFINES "GROSS INCOME" TO INCLUDE "GAINS * * * DERIVED FROM ANY SOURCE WHATEVER," MUST BE INTERPRETED IN THE LIGHT OF THE CONGRESSIONAL POLICY TO TAX INCOME COMPREHENSIVELY, AND PLAINLY COVERS RECEIPTS FROM PUNITIVE DAMAGES

We start with the words of the statute which are clear and comprehensive. Since the Revenue Act of 1913, which was enacted a few months after the Sixteenth Amendment became effective, Congress has defined "income" or "gross income" to include "gains, or profits and income derived from any source whatever," and has provided certain exemptions from tax. *E. g.,* Revenue Act of 1913, c. 16, 38 Stat. 114, 167; Internal Revenue Code of 1939, Section 22 (a), 26 U. S. C. 22. The same language has for many years been included in the applicable regulations. Cf. Article 4 of Treasury Regulations 33 (1918 ed.) promulgated under the Revenue Act of 1916 with the current Section 29.22 (a)–1 of Treasury Regulations 111, *supra,* pp. 3, 4. Webster defines gain as "increase in profit, resources, or advantage acquired." The essence of gain is thus increase in resources.

This is the foundation of our position. Congress has plainly imposed a tax on all gain received by the taxpayer (not including return of capital),[7]

[7] It should be noted that the court below (R. 36) incorrectly stated our position to be that "*any* money or property coming into the hands of any person is taxable as income unless specifically exempted" (italics supplied) and thus to be "a complete negation of the concept of source in relation to taxable income." Source, of course, determines whether money or property constitutes *gain* as distinguished from capital or a return of capital.

except such gain as has been by law specifically exempted from tax.

This Court has many times had occasion to comment on the generality of the statutory language. "The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories". *Helvering* v. *Clifford,* 309 U. S. 331, 334. And the Court has cautioned that the construction of the statute "should be consonant with that purpose". *Ibid.* Similarly, in *Commissioner* v. *Jacobson,* 336 U. S. 28, 49, the Court said that "The income taxed is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively". See further, e. g., *Irwin* v. *Gavit,* 268 U. S. 161, 166; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.,* 297 U. S. 88; *Rutkin* v. *United States,* 343 U. S. 130.

The payments received by taxpayers as punitive damages constituted gain to them and it is not contended that they constituted return of capital or fall within any of the exemptions provided by Congress.[8] Accordingly, we believe that the payments fall within the plain meaning of Section 22 (a) which covers "gains * * * from any source whatever" and are subject to tax.

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[8] Inasmuch as the court below referred by analogy to cases involving the taxability of certain capital contributions and to cases involving the exemption provided by law for gifts, we say more on these subjects in Section III, *infra,* p. 32.

II. NEITHER THE CONSTITUTION NOR THE DECISIONS OF THIS COURT LIMIT GAIN SUBJECT TO TAX SO AS TO EXCLUDE RECEIPTS ON ACCOUNT OF PUNITIVE DAMAGES

A. *Under the Constitution, Congress always has had the power to tax receipts not derived from property without apportionment.*

The basic power "To lay and collect Taxes" is granted to Congress by Article I, Section 8, Clause 1 of the Constitution. The authority so conferred "is exhaustive and embraces every conceivable power of taxation" except as the Constitution expressly imposes its own limitations. *Brushaber* v. *Union Pacific R. R.*, 240 U. S. 1, 12–13; see also, *Steward Machine Co.* v. *Davis*, 301 U. S. 548. The Constitution itself imposed but two restrictions upon the exercise of that power here relevant:[9] (1) "Duties, Imposts, and Excises" must be "uniform throughout the United States" (Art. I, Sec. 8, Cl. 1), which requires only geographical uniformity in application (*Knowlton* v. *Moore*, 178 U. S. 41, 83–109; *Fernandez* v. *Wiener*, 326 U. S. 340, 361), and (2) "direct Taxes" must be "apportioned among the several States" according to population (Art. I, Sec. 2, Cl. 3; Art. I, Sec. 9, Cl. 4). The restrictions "were not so much a limitation upon the complete and all embracing authority to tax" as they were

[9] Article I, Section 9, Clause 5, provides a third restriction on the taxing power—that no tax or duty may be laid on exports.

"regulations concerning the mode in which the plenary power was to be exerted". *Brushaber* v. *Union Pacific R. R.*, 240 U. S. at 13.

As this Court said in upholding the constitutionality of the income tax provisions of the revenue act of 1913, the power of Congress "to lay and collect income taxes" has "never been questioned from the foundation" (*id.* 12–13). The income tax acts of the Civil War period were classed by Congress and the text writers of the day as excises and not as taxes directly on property because of its ownership (*id.* 15). But in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, it was held that a tax upon the income (or gain) from real or invested personal property was a direct tax in the constitutional sense, because in substance it imposed a burden on property and under the Constitution was required to be apportioned among the states. This decision detracts not at all from the acknowledged plenary power of Congress to levy taxes generally; indeed the Court there expressly recognized the validity of uniform taxes on income from "professions, trades, employments, or vocations" (158 U. S. at 637) and invited attention to the fact that such taxes had been sustained in the past as excises (*id.* at 635). See *Brushaber* v. *Union Pacific R. R.*, 240 U. S. at 16–17.

The constitutional restriction which the *Pollock* case imposed on unapportioned taxes on gain

from property was removed by the Sixteenth Amendment, which provides:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Congress had always had the power to lay and collect taxes on income or gain of any sort. That power was neither conferred nor limited by the Amendment. "It is clear on [its] face * * * that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived." *Brushaber* v. *Union Pacific R. R. supra,* pp. 17–18; *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103, 112–113.

The Sixteenth Amendment changed the law *only* with respect to taxes on gain from property; as to such gain it removed the constitutional requirement of apportionment. But with respect to gain from all other sources, including gain or receipts from the payment of punitive damages, Congress always has had and has the power to levy taxes provided only that they are geographically uniform. The question presented here is thus simply one of statutory construction, namely, whether Congress excluded from tax payments of punitive damages, notwithstanding that it comprehensively declared subject to tax "gains * * * from any source whatever."

**B.** ***The definition of income used by this Court to distinguish income from capital in Eisner v. Macomber has not been regarded by this Court or by courts of appeals other than the court below as limiting gain subject to tax under the Internal Revenue Code.***

The court below, in concluding that the statutory language used by Congress did not cover payments of punitive damages, relied primarily on the definition of income used by this Court in *Eisner* v. *Macomber*, 252 U. S. 189. That case involved the taxability under the Constitution of a stock dividend which did not change the preexisting proportionate interests of the stockholders. The issue was whether a tax on such a dividend was a tax on property (capital), and hence under the Constitution was subject to apportionment as a direct tax, or whether it was a tax on income, as declared by Congress,[10] and hence under the Sixteenth Amendment was free of the requirement of apportionment.

In approaching this question the Court first looked to the teachings of the economists as to the "fundamental relation of 'capital' to 'income'." Then it looked to the dictionaries and adopted for the purpose of distinguishing income from capital the following definition of income (252 U. S. at 207):

> "Income may be defined as the gain derived from capital, from labor, or from

[10] The Revenue Act of 1916, under which the case arose, provided that a "stock dividend shall be considered income, to the amount of its cash value" (39 Stat. 756, 757).

> both combined," provided it be understood to include profit gained through a sale or conversion of capital assets.

The Court emphasized that income was *gain* "derived from" not "accruing to" capital, something "severed from" capital and "received by" the taxpayer "for his separate use" (*ibid.*). Returning to an analysis of the character of the stock dividend before it, the Court found that "the essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit" (*id.* at 211). Accordingly the Court held that the tax was a tax on capital and, as such, unconstitutional unless apportioned.

For the purpose of distinguishing income (gain) from capital, the broad definition served the Court adequately and for similar general purposes has frequently been quoted. See *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *Goodrich* v. *Edwards*, 255 U. S. 527; *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170; *Taft* v. *Bowers*, 278 U. S. 470; *Lucas* v. *Alexander*, 279 U. S. 573; cf. *United States* v. *Phellis*, 257 U. S. 156; see also, *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179. In these cases the definition was used, as in *Eisner* v. *Macomber*, to determine that taxes on *gain* from property (which might, because derived from property, be held to be taxes on property and therefore subject to apportionment unless within the scope of the Sixteenth Amendment) were in fact within the scope of that

Amendment. For example, in *Merchants' L. & T. Co.* v. *Smietanka, supra,* the Court considered the taxability of the difference between the 1917 sale price and the March 1, 1913, value of certain trust assets. The Court stated that "very certainly" the gain in question fell within "the comprehensive last clause [of the statute] 'gains or profits and income derived from any source whatever' ". But since the gain in question was derived from property, the Court found it necessary to consider whether the gain was "income" as that term was used in the Sixteenth Amendment. The Court used the *Eisner* v. *Macomber* definition to support its conclusion that the gain in question, which had been produced by and severed from the investment by the sale for cash (255 U. S. at 520):

> * * * thereby became that "realized gain" which has been repeatedly declared to be taxable income within the meaning of the constitutional amendment and the acts of Congress.

But, as we have seen, we are not here concerned with the scope of the Sixteenth Amendment. Taxes on receipts such as those here in issue were taxable without apportionment before the Sixteenth Amendment.[11] Our only question is

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[11] We think it clear that the payments of punitive damages were not derived from property of the taxpayer in any sense which would make them direct taxes subject to apportion-

whether a generalization [12] used by the Court to distinguish income from capital is to be taken as restricting or modifying the breadth of the language used by Congress in declaring subject to tax "gains or profits and income derived from any source whatever." At most the *Eisner* v. *Macomber* generalization is but a gloss on the statute, and what is controlling are the words of the statute rather than what was said about one of them, "income", in another context.

This Court, on several occasions, has rejected the notion, adopted by the court below, that the *Eisner* v. *Macomber* definition restricts the scope of the statutory language.[13] The court first did this explicitly in *United States* v. *Kirby Lumber Co.*, 284

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ment under *Pollock* v. *Farmers' Loan & Trust Co.*, discussed *supra*, pp. 17–18. But if they should be considered as derived from property (see pp. 26–27, *infra*) and hence of the sort which would have been subject to apportionment under Art. I of the Constitution, then, as realized gain *from property*, they would be "income" within the meaning of the Sixteenth Amendment. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509.

[12] *Cf.* Surrey and Warren, *A. L. I. Income Tax Project*, 66 Harv. L. Rev. 761, 770: "Essentially, the *Eisner* v. *Macomber* statement is a generalization rather than a definition."

[13] The *Eisner* v. *Macomber* decision itself has been limited to its particular facts. As the Court stated in *Helvering* v. *Griffiths*, 318 U. S. 371, 375, 393, in *Koshland* v. *Helvering*, 298 U. S. 441, "The Court * * * in effect limited *Eisner* v. *Macomber* to the kind of dividend there dealt with" and in *Helvering* v. *Bruun*, 309 U. S. 461, "rejected the concept that taxable gain could arise only when the taxpayer was able to sever increment from his original capital".

U. S. 1. There the taxpayer, which had issued its bonds and received their par value, later purchased some of the bonds at less than par and the question was whether the difference between the par value and purchase price was income. Accepting the taxpayer's contention that the item in controversy was not income because it was not gain derived from capital or labor or both combined (44 F. 2d 885, 886), the Court of Claims held that it was not "income" though obviously "gain" (44 F. 2d at 887), relying upon this Court's then recent reiteration of the *Eisner* v. *Macomber* definition in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170. This Court reversed the Court of Claims, stating (284 U. S. at 3) that under the applicable revenue act gross income includes "gains or profits and income derived from any source whatever", that in the *Kerbaugh-Empire Co.* case the whole transaction resulted in a loss, and that—

> Here there was no shrinkage of assets and the taxpayer made a *clear gain.* As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. *We see nothing to be gained by the discussion of judicial definitions.* The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here. *Burnet* v. *Sanford & Brooks*

> *Co.*, 282 U. S. 359, * * *. [Italics supplied.] [14]

See also *Helvering* v. *Amer. Chicle Co.*, 291 U. S. 426; *Commissioner* v. *Jacobson*, 336 U. S. 28.

In *Helvering* v. *Bruun*, 309 U. S. 461, this Court again refused to treat the *Eisner* v. *Macomber* definition as if it were a specific blueprint defining the scope of the word "income" for all purposes. In that case a landlord was taxed for the increased value of repossessed land on which the tenant had put a building. Citing *Eisner* v. *Macomber*, the Court said (*id.* at 468–469):

> * * * These expressions, however, were used to clarify the distinction between an ordinary dividend and a stock dividend. They were meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared. We think they are not controlling here.

More recently in *Rutkin* v. *United States*, 343 U. S. 130, the Court held that money obtained by extortion constituted taxable income. The

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[14] It has been stated that in the *Kirby Lumber Co.* case this Court "recognized the futility of attempting to capture the concept of income and confine it within a phrase" and "explicitly abandoned the search for a definition." Surrey and Warren, *A. L. I. Income Tax Project*, 66 Harv. L. Rev. 761, 771.

extorted money ($250,000) not only was not derived by the taxpayer-extortionist from capital or labor or both combined, at least in any usual sense of those terms, but was money for which the taxpayer "had no basis for his claim." (*Id.* at 135.) The Court concluded, nevertheless, that Section 22 (a) "reaches these receipts", stating that the power of Congress to tax the receipts is "unquestionable" and that the broad language of Section 22 (a) "supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income". (*Id.* at 138–139.)

Other cases in which the Court has quoted the Section 22 (a) definition of gross income as including "gains or profits and income derived from any source whatever" and held gains subject to tax which do not come within the *Eisner* v. *Macomber* definition include: *Irwin* v. *Gavit,* 268 U. S. 161 (payments received pursuant to bequest of income from a trust); *United States* v. *Safety Car Heating Co.,* 297 U. S. 88 (sum received in settlement of a patent infringement suit for lost profits); and *Robertson* v. *United States,* 343 U. S. 711 (sum received as a prize for a symphony).

*Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, involved the taxability of the sums received in settlement of litigation which represented partial recoveries of losses on the sale of stock the purchase of which had been induced by fraudulent representations. The

Court there upheld the Tax Court's conclusion that, to the extent that deductions of the losses in prior years had offset gross income for those years, the recoveries must be treated as taxable income (320 U. S. at 507). As taxable income, those recoveries had their direct source in the prior tax benefits for they would otherwise have constituted a return of capital.

Of course most gain has some relation to labor or capital, and, in a loose sense, may be said to be derived therefrom. Thus the activity involved in ~~an embezzlement~~ extortion, in repossessing land following default under a lease, in the settlement of a lawsuit, in entering a contest, or in purchasing at a discount one's own promissory obligations, to take the examples of the cases discussed above, could be said to be "labor".

In a similar sense, the punitive damages received by the taxpayers here could be said to derive from "labor" or "capital" or both. Thus the punitive damages were derived from litigation, in which taxpayers employed both capital and labor, based on causes of action (a species of property, I Sutherland on *Damages,* Sec. 7 (1916)) which were in turn based upon claims which had their origins in taxpayers' businesses, in which both capital and labor were used. In the case of the antitrust suits, the punitive damages were, in addition, directly dependent upon a showing of actual dam-

ages to taxpayers' businesses.[15] 15 U. S. C. 15, *Keogh* v. *C. & N. W. Ry. Co.*, 260 U. S. 156, 164–165. Moreover, inasmuch as punitive damages arise from business or dealings in property in that they can be recovered only if some property or property right has been damaged, they could be said to fall within the language of Section 22 (a) as among the "gains * * * of whatever kind * * * from * * * businesses * * * or * * * growing out of the ownership or use of * * * such property," as well as within the comprehensive last clause of Section 22 (a) which includes "gains * * * from any source whatever". See 101 U. of Pa. L. Rev. 1052, 1065.

But we think little is to be gained from attempting to make the Court's generalization in *Eisner* v. *Macomber* serve, in substitution for the words of Congress in Section 22 (a), as a definition of income. It was plainly not intended by this Court so to be used, and it cannot, consistently with the decisions of this Court, be taken as restricting the plain meaning of the words used by Congress in the Code.

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[15] That was not true as to that part of the punitive damages received by Glenshaw in settlement of its fraud action against Hartford. Prior to the settlement agreement between Glenshaw and Hartford (which covered both the fraud action and an antitrust suit), it had been held that punitive damages for fraud were to be awarded Glenshaw in the light of the enormity of Hartford's offense, rather than the actual damages to Glenshaw, because Hartford's fraud was gross and outrageous. *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 F. 2d 474 (C. A. 3d).

The Court of Claims and other courts of appeals, following the decisions of this Court, have rejected the contention that the general definition of income used by this Court in *Eisner* v. *Macomber* restricts the scope of Section 22 (a) in cases involving amounts received as statutory penalties or as punitive damages.

*Park & Tilford Distillers Corp.* v. *United States,* 107 F. Supp. 941 (C. Cls.), certiorari denied, 345 U. S. 917, involved the taxability of "insider profits" received as a windfall by the taxpayer corporation. In that case an officer-director of the taxpayer-corporation owning more than 10 percent of the stock of the corporation had purchased and sold stock of the corporation on the open market within a six-month period and realized what are called "insider profits." Under Section 16 (b) of the Securities Exchange Act of 1934, c. 404, 48 Stat. 881, he was required to turn over to the corporation his profits from the sales and, upon demand by the corporation, did so. As to the officer-director, the payment to the corporation constituted a penalty. See *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (C. A. 2d), certiorari denied, 320 U. S. 751; *Davis* v. *Commissioner,* 17 T. C. 549. The question was whether the payment constituted taxable income to the taxpayer-corporation. In holding that it did, the Court of Claims regarded the payment as a "penalty" to the payor and a "windfall" to the recipient-corporation and held that it "could

not rationally be suggested that Congress lacks the power to tax windfalls as income" (107 F. Supp. at 943), that the payment was "income derived from any source whatever" under Section 22 (a) of the Code (p. 942), that it saw "no reason for not giving the statutory language its natural meaning" (p. 942), that "If Congress were to select one kind of receipt of money which, above all others, would be a fair mark for taxation, it might well be 'windfalls'" (p. 942), that it was "unwilling to surmise" that by the *Eisner* v. *Macomber* definition this Court intended to read "income derived from any source whatever" out of Section 22 (a) (p. 943), that the fact that the payment was a penalty to the payor had no bearing on the question of taxability to the recipient (p. 944), and that "Cases such as *Central R. Co. of New Jersey* v. *Commissioner*, 3 Cir., 79 F. 2d 697, and *Highland Farms Corporation*, 42 B. T. A. 1314, 1319, which seem to rest only upon the definition of income given by the Supreme Court in *Eisner* v. *Macomber*, do not seem to us persuasive" (p. 945).

More recently the Tax Court [16] and the Court of Appeals for the Second Circuit in *General*

[16] In the *General American Inv. Co.* case the Tax Court held (19 T. C. 581), by approving the decision of the Court of Claims in the *Park & Tilford Distillers Corp.* case, that the *Eisner* v. *Macomber* definition of income is not controlling, whereas in the present cases the Tax Court held (R. 16–17, 29) that punitive damages do not constitute taxable income because they do not come within the *Eisner* v. *Ma-*

*American Investors Co.* v. *Commissioner*, 19 T. C. 581, 211 F. 2d 522, certiorari granted, Oct. 14, 1954, No. 114, this Term, followed the lead taken by the Court of Claims in *Park & Tilford* in another case arising with respect to profits turned over to a corporation pursuant to Section 16 (b) of the Securities Exchange Act of 1934. The taxpayer-corporation there also "relie[d] principally" upon the *Eisner* v. *Macomber* definition of income, which the Court stated did not cover the payments involved "If this definition is to be regarded as all inclusive, and to be applied literally" (211 F. 2d at 523). In answering the taxpayer's argument, the court stated that the *Eisner* v. *Macomber* definition "has met the common fate of generalities" (p. 523), that "it will not help to characterize these payments as a 'windfall' to the corporation or as in the nature of a 'penalty' imposed upon the director and the stockholder" (p. 524), and that "if we consider the words 'gains or profits and income derived from any source,' 'in their plain popular meaning,' as we think they should be, how can there be any doubt that these Section 16 (b) payments are 'income'?" (p. 524).[17]

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*comber* definition. The Tax Court has therefore placed itself in the inconsistent position of holding both that the *Eisner* v. *Macomber* definition is and is not controlling.

[17] The court below regarded the *Park & Tilford Distillers Corp.* and *General American Inv. Co.* decisions as distinguishable from the present cases (R. 36), stating, among other things, that it did not agree with the Court of Claims

The precise question involved here—whether punitive damages received as treble damages under the antitrust laws constitute taxable income—was before the Court of Appeals for the Seventh Circuit in *Commissioner* v. *Obear-Nester Glass Co.*, decided November 15, 1954, pending on petition for certiorari, No. 478, this Term. After reviewing the cases, the court concluded that this Court in *Eisner* v. *Macomber* "was merely borrowing a definition of income to support its holding that income attributable to capital must come from it, i. e., be separately expendable, and that it did not consider that definition all encompassing." It did not believe "that the Supreme Court intended to define income exclusively according to its source." It noted that the fundamental principle upon which the income tax is based "is that individuals will be taxed according to their ability to pay." Since windfalls, perhaps above all other sources of income, enhance

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in the *Park & Tilford Distillers Corp.* case that the recovery there was purely a windfall (R. 35). The distinction drawn by the court below between those cases and the instant cases seems to be that under the statute involved in those cases the profits were required to be passed on, and inured to the corporation. But as the Court of Appeals for the Second Circuit stated in its *General American Inv. Co.* decision, such reasoning "will not bear analysis," for the "payments were not 'profits' to petitioner, although they represented 'profits' realized by the director and the stockholder." (211 F. 2d at 524.) The Court of Appeals for the Seventh Circuit in *Commissioner* v. *Obear-Nester Glass Co.*, decided November 15, 1954, quoted and said it agreed with this analysis.

one's ability to pay, it could not conceive that Congress had intended to exclude punitive damages from taxable income.[18] It held accordingly that punitive damages were taxable under Section 22 (a) of the Internal Revenue Code.

### III. THERE IS NO LONG STANDING RULE THAT PUNITIVE DAMAGES DO NOT CONSTITUTE TAXABLE INCOME

The court below appears to have been influenced by an assumption, which may have stemmed from statements to that effect in the decisions of the Tax Court in these cases (R. 16, 30), that it was a rule of long standing that punitive damages were not subject to tax.[19] In this too we think the court below was on weak ground.

The notion that there is a long standing rule stems from two decisions—the decision of the court below in *Central R. Co.* v. *Commissioner*, 79 F. 2d 697, decided in 1935, and the Tax Court's

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[18] The court seemed to assume that the payments had to qualify as "income" under the Sixteenth Amendment for the tax to be constitutional. For reasons stated *supra*, pp. 16–19, we think that this assumption is based on a mistaken view of the requirements of the Constitution and the nature of the Sixteenth Amendment, but as we also point out, p. 22, n. 11, *supra*, should the payments be considered to be "derived from property" and hence subject to apportionment, they are for that same reason "income" within the meaning of the Sixteenth Amendment.

[19] The court below acknowledged that "The position of the United States would indeed, if adopted, bring symmetry into this aspect of the law of income taxation," and added "But we think if such a result is to be achieved after nearly two decades it should be effected by the Supreme Court and not by this tribunal" (R. 37).

decision in *Highland Farms Corp.* v. *Commissioner*, 42 B. T. A. 1314, 1322, decided in 1940.[20] The *Central R. Co.* case did not involve punitive damages and therefore could not establish any rule specifically as to punitive damages. It was held in that case, however, that gain which is paid as a penalty and received as a windfall is nontaxable to the recipient as not coming within the *Eisner* v. *Macomber* definition of income. Relying upon that holding, the Tax Court held in the *Highland Farms Corp.* case that punitive damages do not constitute taxable income.

One decision of the Tax Court could hardly establish a rule that punitive damages are not sub-

[20] Contrary to an intimation of the court below (R. 33), the pertinent Treasury Regulations have never adopted the *Eisner* v. *Macomber* definition as restricting gain subject to tax or suggested that windfall receipts are not to be taxed. All of the Regulations since 1918 have provided that gross income includes gains or profits and income derived from any source whatever unless exempted from tax by law. See pp. 14–15, *supra*. Following this Court's decision in *Eisner* v. *Macomber*, there was added to the Regulations (Art. 31 of Treasury Regulations 45 (1921 ed.)), the following: "*In general*, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets." (Italics supplied.) But these same Regulations (Art. 21), also for the first time, defined "income (in the broad sense)" to mean "all wealth which flows in to the taxpayer other than as a mere return of capital" and "Gross income" to mean "income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the statute." These all-inclusive definitions of income and gross income are included in the same terms in current Section 29.21-1 of Treasury Regulations 111, *supra*, pp. 3–4.

ject to tax. In 1940, when the Tax Court applied the *Central R. Co.* decision to punitive damages in the *Highland Farms Corp.* case, the Commissioner published his non-acquiescence in the Tax Court's holding (1941–1 Cum. Bull. 16), thereby showing that he was adhering to his position that punitive damages constitute taxable income and warning everyone that the contrary holding in the *Highland Farms Corp.* case was not being accepted by the Treasury. The Commissioner's position that punitive damages constitute taxable income was not again attacked in the courts until the present *Glenshaw* case.

The premise of the Tax Court's decision in the *Highland Farms Corp.* case—that taxable income is limited by a narrow interpretation of the *Eisner* v. *Macomber* definition of income—has always been questionable. It was based on the *Central R. Co.* decision which, so far as we are aware, has never been followed, except in the *Highland Farms Corp.* case, in respect of its holding that the receipt of a penalty does not constitute taxable income.[21] The *Central R. Co.*

[21] The court below stated that its *Central R. Co.* decision "has been followed frequently" (R. 37) and must have had reference to decisions which Glenshaw cited in the court below in support of an assertion that the other circuits had uniformly accepted the principle of the *Central R. Co.* decision. Not one of the cited cases approved the principle of *Central R. Co.* which the court below applied in the present cases. *Central R. Co.* was cited in *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110, 113 (C. A. 1st), certiorari denied, 323 U. S. 779, and in *White* v. *Thomas*, 116

decision was criticized by the Second Circuit in *Sterling* v. *Commissioner,* 93 F. 2d 304, certiorari denied, 303 U. S. 663, and again in *Lyeth* v. *Hoey,* 96 F. 2d 141, reversed on other grounds, 305 U. S. 188. On its facts the *Central R. Co.* decision was directly contrary to the Fifth Circuit's decision in *Arcadia Refining Co.* v. *Commissioner,* 118 F. 2d 1010. Indeed *Central R. Co.* was decided four years after the *Kirby Lumber Co.* case in which this Court rejected the suggestion that the generalization it used in *Eisner* v. *Macomber* limited or modified the plain meaning of the statutory language.

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F. 2d 147 (C. A. 5th), certiorari denied, 313 U. S. 581, along with other cases for the proposition that whether a settlement sum is taxable depends upon the claim settled. In *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932, 935 (C. A. 9th), in which it was held that a judgment award constituted income as being a recovery for lost profits rather than a return of capital, *Central R. Co.* was distinguished on the ground that it involved a recovery which was neither for profits nor for an injury to capital. *Crews* v. *Commissioner*, 89 F. 2d 412, 415 (C. A. 10th), cited *Central R. Co.* along with *Eisner* v. *Macomber* for the general proposition that gain from property does not become income until it is realized by the taxpayer. *Mathey* v. *Commissioner*, 177 F. 2d 259 (C. A. 1st), certiorari denied, 339 U. S. 943, was also a case in which it was held that a judgment award constituted income as being a recovery for lost profits rather than a return of capital. In rejecting the taxpayer's contention that the recovery was designed to compensate him for capital losses, the court incidentally stated (p. 264) that the award was received "not as a penalty" but to adequately compensate the taxpayer for lost profits. There was no holding that a penalty does not constitute taxable income and the court did not even cite *Central R. Co.*

Since there is no long standing "rule" that receipts on account of punitive damages are not subject to tax, the decisions of this Court which suggest that such interpretations are to be regarded with respect are inapposite. For example, in *Helvering* v. *Griffiths,* 318 U. S. 371, this Court refused to consider whether it should retroactively overrule the holding in *Eisner* v. *Macomber* as to stock dividends for the reason, among others, that to overrule the decision retroactively would mean that for some seven years a multitude of transactions had been taxable although there was no source of law in any of the three branches of the Government from which the most cautious taxpayer could have learned of the liability. But that is most emphatically not the situation here where the only precedent is a Tax Court decision with respect to which the Commissioner published his non-acquiescence.

### IV. PUNITIVE DAMAGES CONSTITUTE GAIN TO THE RECIPIENTS AND ARE NOT EXEMPT AS GIFTS

As we said at the outset (p. 16, n. 8) we feel obliged because of certain analogies drawn by the court below, to discuss further the nature of punitive damages.

There is no question here but that the receipts on account of punitive damages constitute realized gain to the taxpayers concerned. As cash receipts, paid over to taxpayers free of any obligation whatsoever, they were clearly realized.

Similarly they were by definition and in fact gain as distinguished from a return of capital or a contribution to capital. When injury to capital is the basis of a suit which results in an award of damages, the recovery is a return of capital which, since it is not gain, does not constitute taxable income.[22] *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 98. But taxpayers neither claimed nor sustained a loss of capital; indeed in these cases they concede that the compensatory damages they received constituted gain (rather than a return of capital) and as such were taxable.[23] The punitive damages were received in addition to the actual damages and patently could represent nothing but gain.[24]

[22] This statement assumes a return of capital without a tax benefit. A return of capital as to property which has no cost basis to the taxpayer constitutes taxable income. *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110, 114 (C. A. 1st), certiorari denied, 323 U. S. 779.

[23] Goldman reported the compensatory portion of its judgment in its tax return and paid the tax on that portion (R. 27). Glenshaw conceded that some of the items of compensatory damages were taxable and on the controverted items the Tax Court held that the compensatory damages were for lost profits, rather than a return of capital, and therefore taxable (R. 16, 17–19). Glenshaw did not appeal from this determination.

[24] One writer has suggested that the two-thirds portion of a treble damage award under the antitrust laws should be termed "accumulative damages" and be regarded as liquidated compensation for accumulative, indeterminate, intangible, but actual harm going beyond the ordinarily recoverable actual or legal damages. Vold, *Are Threefold Damages*

The decisions relating to governmental subsidies, adverted to by the court below (R. 34, 36), are inapposite to the question whether payments of punitive damages constitute gain to the recipients. In *Edwards* v. *Cuba Railroad,* 268 U. S. 628, it was held that a governmental subsidy payment constituting a *capital contribution* to the railroad did not constitute taxable income, although it was not a mere gratuity. That decision has been criticized for not recognizing that subsidies are gain to the recipients and therefore necessarily either taxable income or gifts,[25] and in *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, this Court indicated approval of the latter approach. But cf. *Brown Shoe Co.* v. *Commissioner,* 339 U. S. 583. Moreover the *Cuba Railroad* doctrine has been restricted in its application to the extent that it is well settled that a subsidy or similar payment by a government constitutes taxable income, rather than a nontaxable capital contribution, when its use is not restricted to capi-

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*under the Anti-Trust Act Penal or Compensatory?*, 28 Ky. L. J. 117, 134–135, 142–147, 155–159 (1939–1940). If so treated, the two-thirds portion of the treble damages would still constitute gain to the recipients either as compensation for additional lost profits or as return on account of intangibles which have no cost basis. See *Raytheon Production Corp.* v. *Commissioner, supra,* p. 114; cf. *Dobson* v. *Commissioner,* 320 U. S. 489, 507, rehearing denied, 321 U. S. 231.

[25] Mandell, *Do Subsidies Constitute Taxable Income?*, 26 Taxes 323 (1948); see also, Freeman and Speiller, *Tax Consequences of Subsidies,* 9 Tax. L. Rev. 255, 267–268 (1953-1954); Magill, *Taxable Income* 340–342 (1936).

tal expenditures. *Texas & Pacific Ry Co.* v. *United States,* 286 U. S. 285; *Lykes Bros. S. S. Co.* v. *Commissioner,* 126 F. 2d 725 (C. A. 5th); *Baboquivari Cattle Co.* v. *Commissioner,* 135 F. 2d 114 (C. A. 9th); see also, *United States* v. *Maryland Jockey Club,* 210 F. 2d 367 (C. A. 4th), certiorari denied, 347 U. S. 1014; *Decatur Water Supply Co.* v. *Commissioner,* 88 F. 2d 341 (C. A. 7th). Whatever vitality the *Cuba Railroad* doctrine may still possess as to subsidy payments, it can have no relevance to the taxability of punitive damages not intended as subsidies or capital contributions nor restricted to use for capital expenditures.

It remains only to note that the amounts received by taxpayers as punitive damages are not exempt under Section 22 (b) (3) as gifts. We would not consider this point worth more than passing mention except for the fact that the existence of the statutory exemption for gifts may have influenced the decision of the court below. It noted the exemption and characterized a punitive damage award as "a gift taken from the pocket of the injuring party by virtue of law" adding that "There is no *quid pro quo*" (R. 36).

We think that the receipts here clearly fall outside the statutory exemption. A gift connotes a donative intent on the part of the donor as well as a complete absence of consideration—a transfer of "something for nothing." E. g., *Commis-*

*sioner* v. *Jacobson*, 336 U. S. 28, 49–51. Payments of punitive damages satisfy neither requirement.

Most assuredly the payments here in question were not made "out of affection, respect, admiration, charity or like impulses," *Robertson* v. *United States*, 343 U. S. 711, 714. The payments were unquestionably involuntary in every sense of the word. Nor did the payments stem from any charitable impulse on the part of the Government. On the contrary, punitive damages, or at least treble damages under the federal antitrust laws,[26] are made available in the interest of better enforcement of the law. Moreover, the recovery of

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[26] In *Bruce's Juices* v. *American Can Co.*, 330 U. S. 743, 751–752, the Court stated that:

"It is clear Congress intended to use private self-interest as a means of enforcement and to arm injured persons with private means to retribution when it gave to any injured party a private cause of action in which his damages are to be made good threefold, with costs of suit and reasonable attorney's fee."

See also *Maltz* v. *Sax*, 134 F. 2d 2, 4 (C. A. 7th), certiorari denied, 319 U. S. 772, where it was stated that the grant of the private cause of action for treble damages:

"was for the purpose of multiplying the agencies which would help enforce the Act and therefore make it more effective."

In speaking of the imposition of double, treble and even quadruple damages, this Court long ago stated in *Missouri Pacific Railway Co.* v. *Humes*, 115 U. S. 512, 523, that:

"experience favors this legislation as the most efficient mode of preventing, with the least inconvenience, the commission of injuries. * * * The injury actually received is often so small that in many cases no effort would be made by the sufferer to obtain redress, if the private interest were not supported by the imposition of punitive damages."

punitive damages by taxpayers was dependent upon the institution of suits based upon rights of action which, at least as to the antitrust suits, required taxpayers to prove actual damage to themselves. Thus, so far as the Government is concerned, the punitive damages were made available by law in consideration of taxpayers' enforcement of the law and proof of injury. In that sense they were compensatory. Cf. *Helvering* v. *Mitchell,* 303 U. S. 391; *United States ex rel. Marcus* v. *Hess,* 317 U. S. 537, 549–552.

The fact that punitive damages may be described as windfalls to the recipient does not make them gifts. A windfall which is not a gift is a gain taxable under Section 22 (a). This Court has consistently upheld taxes on receipts or gains which, in a loose sense, might have been characterized as windfalls. E. g., *Robertson* v. *United States,* 343 U. S. 711 (award for prize winning symphony); *Helvering* v. *Bruun,* 309 U. S. 461 (acquisition on forfeiture of lease, of building constructed by lessee on leased premises). In *Commissioner* v. *Jacobson,* 336 U. S. 28, the gain derived by the taxpayer-debtor from the purchase of his own obligations at a discount was in the nature of a windfall but was held to constitute taxable income, rather than a gift by the seller, because the seller did not have a donative intent. Tips can also be labelled windfalls, but they have been held to constitute taxable income for services rendered. *Roberts* v. *Commissioner,* 176 F. 2d 221 (C. A. 9th); *United*

*States* v. *McCormick,* 67 F. 2d 867 (C. A. 2d), certiorari denied, 291 U. S. 662. A pension received out of retirement deductions by the widow of a city fireman pursuant to state statute is a windfall to the widow but has been held to be taxable income rather than a gift. *Varnedoe* v. *Allen,* 158 F. 2d 467 (C. A. 5th), certiorari denied, 330 U. S. 821; see also *O'Daniel's Estate* v. *Commissioner,* 173 F. 2d 966 (C. A. 2d). "Considering the all-embracing definition of 'gross income' in Section 22", a "windfall" gain accruing to a taxpayer as a result of the devaluation of the pound was held taxable income in *Willard Helburn, Inc.* v. *Commissioner,* 214 F. 2d 815 (C. A. 1st). Windfalls were received by those processors who, upon invalidation of the Agricultural Adjustment Act, c. 25, 48 Stat. 31, were reimbursed for the processing taxes they had paid and passed on to customers under the Act, but such windfalls were held not to constitute gifts and to be subject to the windfall tax imposed by the so-called Unjust Enrichment Act, Section 501 of the Revenue Act of 1936, c. 690, 49 Stat. 1648.[27] *Wilson Milling Co.* v. *Commissioner,* 138 F. 2d 249

[27] A tax of 80 percent was specially imposed on such windfalls by the Unjust Enrichment Act, *supra,* which also prescribed rules to determine liability for the tax. The tax was held to be constitutional in *Wilson Milling Co.* v. *Commissioner, supra.* In the absence of that special Act, the windfalls would have been taxable under Section 22 (a) but only at the ordinary rate of tax and there would have been considerable confusion in determining liability for and in collecting the tax.

(C. A. 8th), certiorari denied, 320 U. S. 800; *Sportwear Hosiery Mills* v. *Commissioner,* 129 F. 2d 376 (C. A. 3d).

This Court has cautioned, in considering whether certain gain to a taxpayer should be excluded from income as a gift, that (*Commissioner* v. *Jacobson,* 336 U. S. 28, 49):

> The income taxed is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively. The exemptions, on the other hand, are specifically stated and should be construed with restraint in the light of the same policy.

These basic policy considerations make it clear that punitive damages cannot be considered exempt from tax as gifts or by any supposed analogy to gifts.

## CONCLUSION

For the foregoing reasons, the judgments of the court below should be reversed.

Respectfully submitted,

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DECEMBER 1954.

U. S. GOVERNMENT PRINTING OFFICE: 1954

Office - Supreme Court, U. S.
FILED
FEB 4 1955
HAROLD B. WILLEY, Clerk

No. 199

# In the Supreme Court of the United States

OCTOBER TERM, 1954

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

WILLIAM GOLDMAN THEATRES, INC.

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

## REPLY BRIEF FOR THE PETITIONER

SIMON E. SOBELOFF,
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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## REPLY BRIEF FOR THE PETITIONER

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In our main brief we have shown that the statutory definition of "gross income", which includes "gain * * * derived from any source whatever", is clear and that neither the Constitution nor the decisions of this Court limit gain subject to tax so as to exclude receipts of punitive damages. This reply brief deals with certain additional matters raised by the contentions of the taxpayers in their respective briefs.

## I

### THE STATUTORY DEFINITION OF INCOME IS CONSTITUTIONAL AND ITS MEANING IS CLEAR: THERE IS NO OCCASION FOR RESORT TO ANY OTHER DEFINITION.

Both taxpayers concede that Congress may constitutionally tax punitive damages and state that the question presented is whether Congress has in fact taxed such receipts. (Glenshaw Br. 4; Goldman Br. 4). We agree that that is the question before this Court. Our answer is that by Section 22 (a) of the Internal Revenue Code of 1939, Congress has taxed "gains or profits and income from any source whatever." We stress the word "gain" because the use of that word in the definition of "income" makes it clear that Congress used the word "income" in a comprehensive sense, i. e., to include all gain. Neither taxpayer has suggested that the payments of punitive damages involved here did not constitute gain to the recipients. That in our view disposes of this case.

Taxpayers base their arguments on the premise that the terms of Section 22 (a) have acquired a judicial gloss, and cite the definition of income used by this Court to distinguish income from capital in *Eisner* v. *Macomber,* 252 U. S. 189. (Glenshaw Br. 7–10; Goldman Br. 5, 9–10.) Both the statutory and the *Eisner* v. *Macomber*

definitions define "income" in terms of "gain"—the former as "gains * * * derived from any source whatever" and the latter as the "gain derived from capital, from labor, or from both combined." The source of the gain is thus the only variant. Since the statutory definition specifically covers gain "derived from any source whatever," there is no room for interpreting the definition as covering only gain from particular sources.[1]

Taxpayers urge that the last clause of Section 22 (a) has no independent content; that it "is no more than a generalized reference to the content supplied the term 'income' by the enumeration of items which precede it". (Goldman Br. 9; *cf.*

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[1] A valid statutory definition is of course controlling over any other meaning or definition. See *Walling* v. *Portland Terminal Co.*, 330 U. S. 148, 150–151; *Western Union* v. *Lenroot*, 323 U. S. 490, 502.

It does not aid taxpayers to rely, as they do (Glenshaw Br. 14–15; Goldman Br. 10–11), upon Section 61 of the 1954 Internal Revenue Code, which omits the phrase "gains or profits and income" and provides that "gross income means all income from whatever source derived, including (but not limited to)" certain listed items. In the first place, Section 22 (a) of the 1939 Code, rather than Section 61 of the 1954 Code, is applicable here. Secondly, it is clear that Section 61 of the 1954 Code was not intended to restrict the meaning of income. The House Ways and Means Committee states in its report: "While the language in existing section 22 (a) has been simplified, the *all-inclusive nature* of statutory gross income has not been affected thereby." [Italics supplied.] H. Rep. No. 1337, 83d Cong., 2d Sess., p. A18. See also, S. Rep. No. 1622, 83d Cong., 2d Sess., p. 168.

Glenshaw Br. 14.) This suggestion lacks merit. Section 22 (a) describes gross income as including "gains, profits, and income derived from" a number of specific sources such as compensation for services, from business, from the ownership or use of property, etc.—sources which may be described broadly as consisting of labor and capital in the usual sense—and then in addition provides that gross income shall include "gains or profits and income derived from *any* source whatever". [Italics supplied.] Since it will not be presumed that this latter clause has no meaning, it must be understood to provide that income includes "gains or profits and income" from sources other than and in addition to the sources specifically enumerated. This is no novel suggestion. Since 1922 the pertinent Treasury Regulations, as they do today, have defined income to include "*all wealth* which flows in to the taxpayer other than as a mere return of capital". [Emphasis added.] Treas. Reg. 111, Sec. 29.21–1 (main brief, p. 3). See further our main brief, p. 34, n. 20.

That Congress intended the statutory language to have such comprehensive scope is evident from the fact that Congress made its own qualifications to the coverage of the statutory language by providing *expressly* for the exclusion of certain gains from tax under subsection (b) of Section 22. Thus, for example, gains by way of gift, bequest, devise, or inheritance, which are obviously not derived from the capital or labor of

the recipient in any usual sense of those words, are specifically excluded from the coverage of Section 22 (a). And as this Court stated in *Commissioner* v. *Jacobson,* 336 U. S. 28, 49, the income taxed under Section 22 (a) "is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively."

## II

### TAXPAYERS' INTERPRETATION OF THE *EISNER* v. *MACOMBER* DEFINITION OF INCOME DEFEATS THEIR OWN CASE

Both taxpayers assert that decisions of this Court on which we rely are reconcilable with the *Eisner* v. *Macomber* definition of income. (Glenshaw Br. 18–20; Goldman Br. 11–13.) Certainly that is not true if taxpayers are relying upon a narrow, literal interpretation of this definition. On the other hand, if taxpayers are relying upon an interpretation of the definition sufficiently broad to cover all such cases, the conclusion is inescapable that the punitive damages involved here constitute income within the *Eisner* v. *Macomber* definition.

A review of the decisions of this Court will make this clear. Thus in the cases involving a taxpayer's purchase of its own obligations at a discount (*United States* v. *Kirby Lumber Co.,* 284 U. S. 1; *Helvering* v. *Amer. Chicle Co.,* 291 U. S. 426; *Commissioner* v. *Jacobson,* 336 U. S.

28), capital was involved but taxability was based "on the increase in net assets which resulted" (*Helvering* v. *Amer. Dental Co.,* 318 U. S. 322, 327). In *Helvering* v. *Bruun,* 309 U. S. 461, where the increased value of land repossessed under a lease by the taxpayer-lessor was held to constitute income, a business transaction was involved but the direct source of the gain was in the lessee's voluntary and fortuitous act of erecting a new building on the property. In *Robertson* v. *United States,* 343 U. S. 711, where the taxable income consisted of a prize-winning award for a symphony, labor may have been necessary to receipt of the award but the award had its more immediate source in a third party's selection of the taxpayer as the prizewinner. In *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, which involved sums received in settlement of litigation representing partial recoveries for losses, the holding that some of the recoveries constituted taxable income (320 U. S., p. 507) was based on the fact that the taxpayers had derived prior tax benefits from deduction of the losses. In *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, where the sum received in settlement of a suit for lost profits for infringement of a patent was held to constitute taxable income, the statute providing for the recovery of damages was one of the sources of the income. In *Rutkin* v. *United States,* 343 U. S. 130, where the

taxable income consisted of extorted money, the threats which were the sole source of the money could hardly be described as "labor" in any familiar sense of the word. In *Irwin* v. *Gavit,* 268 U. S. 161, the taxable income consisted of trust income received pursuant to a bequest which carried no interest in the trust corpus and therefore was not either directly or indirectly derived from capital or labor of the taxapayer.

To assert, as taxpayers do, that the decisions of this Court are reconcilable with the *Eisner* v. *Macomber* definition is merely to recognize that most, if not all, gain can be said to be derived from capital or labor or both. Punitive damages, for example, would appear to be just as much derived from capital and labor as was the income in the foregoing cases. The damages derived from claims which arose in the course of taxpayers' businesses. (See our main brief, p. 27.) Litigation was the means by which the punitive damages were collected, as Goldman states (Goldman Br. 13), but litigation was also the means by which the actual damages in the *Safety Car Heating Co.* case were collected. So far as source is concerned, there is no basis for distinguishing between the recovery of actual damages and punitive damages. It is only the *nature* of the recovery which is different and that can have no relevance so long as punitive damages constitute gain.

## III

### THE CASES HOLDING CERTAIN OTHER TYPES OF RECEIPTS NOT TAXABLE ARE DISTINGUISHABLE

The decisions holding some categories of receipts not subject to tax, relied on by Glenshaw (Glenshaw Br. 16–17), have no persuasive bearing on this case. In some instances, unlike the present case, difficulty is encountered in determining whether a receipt constitutes *gain,* as in the case of the stock dividends involved in *Eisner* v. *Macomber.* Alimony is a borderline instance. In *Gould* v. *Gould,* 245 U. S. 151, the Court held that alimony did not constitute taxable income under the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, but Section 22 (k) of the 1939 Code contains express provisions taxing periodic alimony payments and the lower courts have found no constitutional impediment to applying the section. See *Mahana* v. *United States,* 88 F. Supp. 285 (C. Cls.), certiorari denied, 339 U. S. 978; *Fairbanks* v. *Commissioner,* 191 F. 2d 680 (C. A. 9th), certiorari denied, 343 U. S. 915. Recoveries for libel *per se* and for breach of promise to marry have been excluded from income on the ground that the damages are reimbursement for injuries which are personal and merely make the taxpayer whole, as distinguished from giving him a profit or gain. *Hawkins* v. *Commissioner,* 6 B. T. A. 1023: *McDonald* v. *Commissioner,* 9 B. T. A. 1340. As we show in our main brief (pp.

39–40), the governmental subsidy payments involved in *Edwards* v. *Cuba Railroad,* 268 U. S. 628, were excluded from income on the ground that they constituted a *capital contribution* and the doctrine of that case is inapplicable where use of the subsidy payments is not restricted to capital expenditures (*Texas & Pacific Ry. Co.* v. *United States,* 286 U. S. 285).[2] Moreover it is clear that the payments to taxpayers here were not intended as subsidies. *Commissioner* v. *Inland Finance Co.,* 63 F. 2d 886 (C. A. 9th), involving the forfeiture of stock subscriptions upon non-payment of other deferred installments, was apparently decided on the basis of a narrow interpretation of the *Eisner* v. *Macomber* definition and is inconsistent with statements of this Court in *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98. In *United States* v. *Supplee-Biddle Co.,* 265 U. S. 189, the Court held that a statutory exemption of insurance proceeds as to individuals applied to corporations and did not decide whether Congress could tax them as income.

## IV

### THE COMMISSIONER HAS CONSISTENTLY MAINTAINED THAT PAYMENTS OF PUNITIVE DAMAGES MUST BE INCLUDED IN THE INCOME OF THE RECIPIENT

Both taxpayers argue that the non-taxability of punitive damages is a rule of long standing which

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[2] *Brown Shoe Co.* v. *Commissioner,* 339 U. S. 583, is a related case but did not involve the taxability of subsidies.

should not be changed except by legislative action. (Glenshaw Br. 24–26; Goldman Br. 4–8.) We anticipated and answered that argument in our main brief (pp. 33–37) but taxpayers persist in assuming that punitive damages have not been taxed since the 1940 decision of the Tax Court in *Highland Farms Corp.* v. *Commissioner,* 42 B. T. A. 1314, 1322. As we stated in our main brief, the Commissioner published his non-acquiescence in the Tax Court's holding in that case that punitive damages do not constitute taxable income and thereby served notice that he was going to continue to tax punitive damages. He has done so, as his determination of deficiencies against these very taxpayers attests. To require taxpayers to pay tax on the punitive damages received by them will merely put taxpayers on an equality with other taxpayers who over the years have been taxed, pursuant to the Congressional direction as expressed in Section 22 (a) of the 1939 Code, on "gains or profits and income derived from any source whatever."

Respectfully submitted.

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FEBRUARY 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955

Office - Supreme Court, U. S.
FILED
MAR 14 1955
HAROLD B. WILLEY, Clerk

LIBRARY
SUPREME COURT, U.S.

No. 199

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*v.*

GLENSHAW GLASS COMPANY

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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WILLIAM GOLDMAN THEATRES, INC.

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

## SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

SIMON E. SOBELOFF,
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*Department of Justice, Washington 25, D. C.*

# In the Supreme Court of the United States

OCTOBER TERM, 1954

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No. 199

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GLENSHAW GLASS COMPANY

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

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In the course of oral argument in these cases on February 28, 1955, the Court asked the Solicitor General to submit a memorandum reviewing the administrative practice as to the taxability of payments of punitive damages and certain other types of gains which it was suggested might be analogous. This memorandum is submitted pursuant to that request.



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# I

## ADMINISTRATIVE PRACTICE

The Commissioner of Internal Revenue, after a review of the pertinent records on file in his office, informs us that, so far as research discloses, the policy position and administrative practice of the Internal Revenue Service with respect to the items in question is and has been as follows:

1. *Damages to property.*

(a) *Actual damages.*

The Commissioner has consistently held recoveries on account of actual damages to business or property to be taxable in so far as they represent damages for lost profits or damages to property which has no tax basis. The files reveal instances in 1922 (settlement of antitrust suit for damages); 1925 (recovery by corporation against directors for improper diversion of funds); 1927 (damages for unfair competition); 1930 (recovery by landowner for destruction of wild fur-bearing animals); 1930 (recovery for injury to water rights of taxpayer). See further *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; Govt. Main Brief, p. 38.

(b) *Punitive damages.*

The Commissioner has consistently held punitive damages recovered in actions involving injury to business to be taxable as income. Thus, in 1919, the Commissioner ruled that damages recovered by an attorney in an action for libel of his professional reputation were taxable as

income. The damages included both general and punitive damages. A summary of this ruling is published in 1 Cum. Bull. 65 (1919).

A search of the files reveals no further rulings as to the taxability of punitive damages arising out of injury to business until the *Highland Farms* case. As is apparent from the decision in *Highland Farms Corp.* v. *Commissioner,* 42 BTA 1314, the Commissioner there asserted tax on a payment of $10,000 received by the taxpayer as punitive damages. This item was one of a number of items contested in the suit, and itself accounted for less than five percent of the total adjustments to gross income in issue. The Board decided against the Government on all issues. The Commissioner acquiesced in this decision in part (see 1941–1 Cum. Bull. 16). As to the relatively minor item consisting of punitive damages, however, and certain other issues, the Commissioner published his non-acquiescence therein, thus announcing that he was adhering to his position that punitive damages constitute taxable income and informing all concerned that the contrary holding in the *Highland Farms* case was not accepted by him.[1]

[1] The practice by the Commissioner of indicating acquiescense or nonacquiescence in decisions of the Tax Court dates from the inception of the court, originally known as the Board of Tax Appeals. In the first Cumulative Bulletin published after the organization of the Board, the Commissioner announced that "No decision of the Board of Tax Appeals disallowing a tax determined by the Commissioner

The deficiencies asserted in the instant cases as well as other recent cases [2] indicate that the Commissioner has since consistently adhered to this position. The statements of policy contained in the cited rulings are, of course, binding on the officers and employees of the Internal Revenue Service who administer the income tax laws.

2. *Damages to persons.*

The Commissioner has held that damages to persons are not taxable as income. Where, however, a part of the recovery is earmarked as for lost earnings, the Commissioner has held such recovery to be taxable. The Commissioner has

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to be due will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases unless and until the Commissioner definitely announces his acquiescence in such decision or, if the matter is submitted to the courts, until after final adjudication." III–2 Cum. Bull. IV (1924). The first instance of non-acquiescence occurred in the same year. *Appeal of Joseph Garneau Co.*, III–2 Cum Bull. 304 (1924). In that decision the Commissioner announced that "Pending final adjudication of the matter by the courts, officers and employees of the Bureau of Internal Revenue will disregard this decision of the Board of Tax Appeals and will proceed in the case of assessments made prior to June 2, 1924, in accordance with existing regulations." *Ibid.* Similar announcements of policy have appeared regularly in subsequent issues of the Bulletin. E. g., 1941–1 Cum. Bull. IV; 1948–1 Cum. Bull. IV; 1954–1 Cum. Bull. 3. This practice has been recognized by this Court. *Douglas* v. *Commissioner*, 322 U. S. 275, 286, n. 5; *Helvering* v. *Pfeiffer*, 302 U. S. 247, 249.

[2] *E. g.*, *Obear-Nester Glass Co.* v. *Commissioner*, No. 478, O. T. 1954, pending on writ of certiorari; *Telefilm, Inc.* v. *Commissioner*, 21 T. C. 688.

not specifically ruled on the question whether a recovery of punitive damages in connection with claims for damages to personal rights is taxable as income; the Board of Tax Appeals has expressly reserved this question.

These conclusions are based on the following:

In 1918 the Attorney General ruled that the proceeds of an accident insurance policy were not subject to tax, "the conclusion being based upon the reasoning that the human body is a kind of capital and that the proceeds of the insurance policy really represented a conversion of the capital lost through the injury".[3] See 2 Cum. Bull. 71, 72; T. D. 2747, Treasury Decisions, Internal Revenue, Vol. 20 (Jan.–Dec. 1918), p. 457.

In 1922 the Commissioner issued a general ruling as to the taxability of damages for injury to personal or family rights including damages for alienation of affections,[4] damages for slander or libel of personal character, and money received by a parent in consideration for the surrender of

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[3] The 1939 Code contains a provision exempting compensation for personal injuries or sickness, received under insurance policies or as damages, from tax. Sec. 22 (b) (5). Amounts received under life insurance contracts paid by reason of the death of the insured are also exempt. Sec. 22 (b) (1).

[4] In *McDonald* v. *Commissioner*, 9 B. T. A. 1340, the Board of Tax Appeals held damages on account of breach of promise to marry to be not includible in taxable income. The Commissioner acquiesced in this decision (VII–2 Cum. Bull. 26 (1928)), and thereafter published a ruling consistent with the decision and revoked prior rulings to the contrary.

his right to the custody of his minor child. In that ruling the Commissioner ruled that such receipts are not taxable, reasoning as follows (I–1 Cum. Bull. 92, 93 (1922)):

> * * * In either case the right invaded is a personal right and is in no way transferable. While a jury endeavors roughly to compute the amount of damage inflicted, in the very nature of things there can be no correct estimate of the money value of the invaded rights. The rights on the one hand and the money on the other are incomparable things which can not be placed on opposite sides of an equation. If an individual is possessed of a personal right that is not assignable and not susceptible of any appraisal in relation to market values, and thereafter receives either damages or payment in compromise for an invasion of that right, it can not be held that he thereby derives any gain or profit.

This ruling expressly stated that slander and libel affecting business reputation or property rights were not considered in the ruling.

In 1927 the Board of Tax Appeals held that damages received for injury to personal reputation and health caused by defamatory statements are not income. "Such compensation as general damages adds nothing to the individual, for the very concept which sanctions it prohibits that it shall include a profit. It is an attempt to make the plaintiff whole as before the injury." *C. A.*

*Hawkins* v. *Commissioner,* 6 B. T. A. 1023, 1025. The Board, however, expressly reserved the question as to the taxability of punitive damages, commenting (*ibid.,* p. 1024):

> * * * it is conceivable that since the income tax is primarily an application of the idea of measuring taxes by financial ability to pay, as indicated by the net accretions to one's economic wealth during the year, there may be cases in which taxable income will be judicially found although outside the precise scope of the description already given.

The Commissioner's files further indicate that in a 1946 case involving a settlement agreement under which the taxpayer received an award as damages for "erroneous imprisonment," a portion of which was designated as damages for loss of earnings, the Commissioner held that that portion of the award which covered loss of earnings was taxable as income.

3. *Damages for malicious interference with contract rights.*

The Commissioner's search does not reveal any cases involving damages for malicious interference with contract rights. As a matter of policy, however, the Commissioner would hold such a recovery subject to tax as income to the extent that it represents gain to the taxpayer (such as lost profits), as distinguished from a recovery which merely makes the taxpayer whole.

4. *Proceeds of insurance for loss of occupancy.* In 1920 the Commissioner ruled that recovery under a use and occupancy policy of insurance of a sum of money as compensation for the loss of use of a factory constituted taxable income. 3 Cum. Bull. 89 (1920). This rule is now incorporated in Treasury Regulations 118, Section 39.112 (f)–1 (c) (8), which provides:

> The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

## II

### CONGRESSIONAL MATERIALS

In connection with its consideration of the bill which became the 1954 Code, the House Ways and Means Committee considered the question whether payments of punitive damages should be specifically excluded from tax as income. The Chairman of the Committee, under date of March 3, 1955, has informed the Commissioner of Internal Revenue as follows:

> On January 20, 1954, the Committee, while considering Confidential Committee Print No. 1 dated January 7, 1954, reached section 68 of Confidential Committee Print

No. 1. In this Committee Print, section 68 was under Part III—Items Specifically Excluded from Gross Income. Section 68 in the Confidential Committee Print read as follows:

*Sec. 68. Punitive Damages.*

Gross income does not include amounts received as punitive damages.

The Chief of Staff of the Joint Committee on Internal Revenue Taxation, Mr. Colin F. Stam, presented an explanation of this section as follows:

*Sec. 68. Punitive Damages.*

This is a new section designed to codify the decision of the Tax Court in *Goldman Theatres, Inc.* (1953) 19 T. C. 637. This case held that two-thirds of a treble damage judgment under the Federal antitrust laws represents punitive damages not included in gross income under the 1939 Internal Revenue Code. The exclusion, of course, does not apply to such portion of a damage judgment as represents compensation for loss of earnings.

After this explanation was presented to the Committee, and after some discussion by the Committee, the Committee voted on a roll call vote, a majority of the Members being present, to delete section 68 from the Confidential Committee Print.

## III

### CONCLUSION

The Commissioner has consistently maintained the position that punitive damages arising from actions involving injury to business are taxable as income. More generally, the Commissioner has held that all receipts that constitute gain to the taxpayer constitute taxable income.

The House Ways and Means Committee, moreover, when it recently considered the taxability of punitive damages, *declined* to include in the Code a provision which would have excluded payments of punitive damages from tax.

This is not, therefore, a case like *Helvering* v. *Griffiths,* 318 U. S. 371, where the administrative and legislative history of the matter in issue was overwhelmingly contrary to the position asserted by the Commissioner. By contrast, the Commissioner's position in the instant cases is consistent with that he has maintained over the years, that is, that punitive damages are taxable as income under Section 22 (a).

Respectfully submitted,

SIMON E. SOBELOFF,
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MARCH 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955

SUPREME COURT, U.S.

Office - Supreme Court, U. S.
FILED
AUG 4 1954
HAROLD B. WILLEY, Clerk

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COMMISSIONER OF INTERNAL REVENUE,
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*Respondent.*

---

## BRIEF OF RESPONDENT GLENSHAW GLASS COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954.

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**No. 199**

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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

GLENSHAW GLASS COMPANY
*Respondent.*

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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

WILLIAM GOLDMAN THEATRES, INC.
*Respondent.*

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## BRIEF OF RESPONDENT GLENSHAW GLASS COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

---

### Question Presented.

Did the court below err in holding that the punitive damages received by the respondent did not constitute taxable income?

### Statement of the Case.

The petition for a writ of certiorari seeks to bring before this Court the tax treatment to be accorded to a portion of a lump sum payment made to the respondent by Hartford-Empire Company in settlement of litigation in

which respondent had been obliged to engage for many years in the federal courts and which has already consumed much time and attention on the part of this Court. Petitioner has obscured the nature of that litigation by erroneously characterizing it as based merely upon claims for lost profits. A brief counterstatement of the facts is required in order clearly to disclose the background out of which this proceeding arises.[1]

In 1931 and in the forepart of 1932, the respondent and others formed a corporation, Shawkee Manufacturing Company, which developed and built in respondent's glass container manufacturing plant a new glass feeding machine known as the Shawkee feeder. Respondent was licensed to use the Shawkee feeder free from the payment of any royalties and embarked upon a program of completely outfitting its plant with such feeders in replacement of those licensed by Hartford-Empire Company. (App. 3a-4a)

As the result of a gross fraud upon the United States Patent Office and the federal courts, Hartford obtained an injunction against the respondent in 1934 preventing it from manufacturing, using and selling the Shawkee feeders. In order to continue in business under the restraint of the fraudulent injunction, respondent was compelled to reinstall the Hartford licensed feeders pursuant to agreements imposing onerous royalty burdens upon the respondent and drastically limiting the type of glassware which it could manufacture. (App. 4a-5a, 6a-7a)

Hartford's fraud was brought to light in 1941 in the course of anti-trust proceedings instituted by the United States and which culminated in the opinions of this Court in *Hartford-Empire Co.* v. *United States*, 323 U.S. 386

[1] The term "respondent" as used in this brief refers only to Glenshaw Glass Company. References herein to "App." are to the Appendix to the petition for a writ of certiorari.

(1945); 324 U.S. 570 (1945), holding that Hartford had violated the federal anti-trust laws. (App. 5a)

Following the disclosure of Hartford's fraud in the anti-trust proceedings in the United States District Court for the Northern District of Ohio, respondent terminated its royalty payments to Hartford and instituted proceedings to vacate the fraudulent injunction and for restitution and compensatory as well as punitive damages. (App. 5a-7a) These proceedings also reached this Court in *Shawkee Manufacturing Co.* v. *Hartford-Empire Co.*, 322 U.S. 271 (1944). The Court ruled that Hartford had obtained its judgment against the respondent by successfully using a fraudulent judgment previously obtained against Hazel-Atlas Glass Co., and that under the circumstances, Hartford's failure to make a full disclosure of its fraudulent conspiracy "aggravated the previous deception it had practiced on the Patent Office and the courts." In the *Hazel-Atlas* case, decided by this Court on the same day as the *Shawkee* case, Hartford's fraud was described as follows:

> "Every element of the fraud here disclosed demands the exercise of the historic power of equity to set aside fraudulently begotten judgments. This is not simply a case of a judgment obtained with the aid of a witness who, on the basis of after-discovered evidence, is believed possibly to have been guilty of perjury. Here, even if we consider nothing but Hartford's sworn admissions, we find a deliberately planned and carefully executed scheme to defraud not only the Patent Office but the Circuit Court of Appeals." (322 U.S. 238, 245-6)

Following the decision of this Court in the *Shawkee* case, respondent filed a counterclaim in the original fraudulent injunction proceedings seeking restitution of the royalties paid to Hartford and certain other expenditures incurred

as a result of the injunction, damages for the destruction of its fruit jar business, and punitive damages. (App. 7a-8a) A full trial was had and appeals were prosecuted. With the exception of the claim based on destruction of the fruit jar business, all of the respondent's claims were finally upheld by the United States Court of Appeals for the Third Circuit and the case was remanded to the District Court for the ascertainment of the exact amounts to be awarded to respondent by way of restitution and as punitive damages. *Hartford-Empire Co.* v. *Shawkee Manufacturing Co.*, 163 F. 2d 474 (3rd Cir., 1947). (App. 9a)

Before further proceedings were taken in the District Court, a settlement agreement was entered into by the respondent and Hartford which terminated the litigation and also concluded another pending action, not yet reached for trial, which Hartford had commenced for the collection of royalties and in which respondent had filed a counterclaim for treble damages under the federal anti-trust laws. (App. 6a, 10a-13a)

The settlement payment ultimately accepted by respondent on December 23, 1947, was in the amount of $813,358.24. (App. 12a) Accepting the method of allocation proposed by respondent as a fair and reasonable way of separating the lump sum payment into its component parts, the Tax Court allocated $324,529.95 to punitive damages and held that this amount did not constitute taxable income. (App. 16a, 20a)[2] As to the balance of the settlement payment, the major portion was admittedly taxable because it represented the restitution of royalties and other expenses for which income tax deductions had previously been

[2] The preponderant portion of the amount allocated to punitive damages was based upon respondent's claim for such an award in the fraudulent injunction proceedings. A relatively small amount was based upon respondent's counterclaim against Hartford for treble damages under the federal anti-trust laws. (App. 13a)

taken and allowed. (App. 15a) Only a relatively small amount of the settlement payment was regarded by the Tax Court as representing the recovery of lost profits. (App. 13a, 14a)

Upon the Commissioner's appeal from the decision of the Tax Court to the United States Court of Appeals for the Third Circuit, no question was presented as to the correctness of the Tax Court's decision in treating the balance of the settlement payment, after the deduction of punitive damages, as taxable income. Nor was any question presented as to the propriety of allocating the amount of $324,529.94 to punitive damages. The single question presented was whether the Tax Court correctly held that the portion of the settlement payment which it allocated to punitive damages did not constitute taxable income to the respondent. The Court of Appeals, with six Judges sitting *en banc*, unanimously affirmed the decision of the Tax Court. (App. 34a-44a)

**Summary of Argument.**

There is no conflict between the decision below and that of any other court. Apart from the instant case, the only other decisions dealing with the taxability of punitive damages are those which have been decided by the Tax Court, and all of such decisions are in accord with the decision below.

There is no conflict with the decisions of the Court of Appeals for the Second Circuit and the Court of Claims holding that the recovery of short-swing insider-profits is subject to tax. As the courts have expressly held, such a recovery is distinguishable from punitive damages. Nor is there a conflict in these decisions with respect to the interpretation to be placed upon the decision of this Court in *Eisner* v. *Macomber*, 252 U.S. 189 (1920).

The court below has carefully followed the applicable decisions of this Court regarding the nature of taxable income. The opinion below similarly follows the definition of income contained in the Treasury Regulations to which Congress has given approval by the repeated re-enactment of Section 22(a) of the Internal Revenue Code. The rule that punitive damages do not constitute taxable income is clearly correct and should not be retroactively changed in the absence of express legislative direction.

The instant case does not present a question of sufficient importance to warrant review by this Court. The opinion is narrowly confined to the single issue of the taxability of punitive damages and has no broader significance in the field of income taxation.

## ARGUMENT.

### I.

**The decision of the court below is not in conflict with the decision of any other court.**

The holding of the court below is that punitive damages for fraudulent conduct and the punitive portion of a treble damage award under the federal anti-trust laws do not constitute taxable income. No case decided by any other court has reached a different result so as to present a conflict requiring review by this Court. On the contrary, the only other reported cases dealing with such payments are those decided by the Tax Court, and they have uniformly and consistently reached the same result as did the court below. *Highland Farms Corp.* v. *Commissioner*, 42 B.T.A. 1314 (1940); *Obear-Nester Glass Co.* v. *Commissioner*, 20 T.C. 1102 (1953); *Telefilm, Inc.* v. *Commissioner* 21 T.C. ....., No. 77 (1954)

Petitioner attempts to find a conflict between the decision below and those cases which hold that taxable income is received by the recovery of short-swing insider-profits under section 16(b) of the Securities Exchange Act of 1934. However, the court below carefully distinguished those cases and made it abundantly clear that it was not in conflict with them. The court said:

> "• • • In our opinion the theory of recovery under Section 16(b) of the Securities Exchange Act of 1934 is not a purely punitive one. The statute was designed to prohibit profit being made by an 'insider' possessing peculiar knowledge of future profitable operations of his corporation. The making of a profit by the 'insider' is the mainspring of the statute, a profit required by law to be passed on to the corporation prob-

ably because the corporation is the most convenient receptacle. An 'outsider' purchasing stock in the open market, theoretically at least, would be compelled to pay a higher price because an insider was purchasing stock in the market against him. But, under the operation of the statute, all of the stockholders, save only the 'insider' whose operations were prohibited by statute, would receive via the corporate entity the profit made by the prohibited transaction.

• • •

"The facts of the Park and Tilford and the General American Investors decisions are distinguishable both from those at bar and from *Central R. Co.* v. *Commissioner, supra.*" (App. 40a-41a)

It is apparent from the above language that if a case involving the taxability of a recovery of insider-profits were presented to the court below, its holding would be identical to that of the Court of Appeals for the Second Circuit and the Court of Claims in such cases.

Similarly, the Court of Appeals for the Second Circuit in its insider-profit case expressly pointed out distinguishing considerations which remove any semblance of a conflict between its decision and the punitive damages rule. In *General American Investors Co., Inc.* v. *Commissioner*, 211 F. 2d 522, 523 (2nd Cir., 1954), petition for certiorari pending, No. 114, the court said:

"Policy considerations may in the end play a decisive or persuasive role in the punitive damage, antitrust and faithless fiduciary cases. For, despite the fact that the moneys received in those instances are at the free disposal of those to whom they are paid, and the rationale of such tribunals as have held them not to be 'income' is based principally upon the *Eisner* v. *Macomber* definition, it may be thought by some that the public interest will be better served if such receipts are held not to be subject to the income tax."

Since the court made clear in the *General American Investors Co., Inc.* case that it was expressing no opinion as to the taxability of punitive damages, no conflict exists between the Circuits on this issue.

Nor can any conflict be established by the dictum in *Park & Tilford Distillers Corp.* v. *United States,* 107 F. Supp. 941 (Ct. Cl. 1952) certiorari denied, 345 U.S. 917. That case was decided prior to the entry of the decision below and the only punitive damages case referred to in the opinion is *Highland Farms Corp.* v. *Commissioner,* 42 B.T.A. 1314 (1940). The fact that the Court of Claims did not regard that decision of the Board of Tax Appeals as persuasive on the issue of whether insider-profits constitute taxable income, certainly does not establish a conflict between its decision and the subsequent opinion in the case at bar.

A conflict between the insider-profits and punitive damages cases would have compelled the Tax Court to choose one rule or the other in its disposition of such cases. However, as noted above, the Tax Court has consistently held that punitive damages do not constitute taxable income, and it has also uniformly ruled that the recovery of insider profits does represent taxable income. *General American Investors Co., Inc.* v. *Commissioner,* 19 T.C. 581 (1952), aff'd. 211 F. 2d 522 (2nd Cir., 1954); *Noma Electric Corp.* v. *Commissioner,* 12 T.C.M. 1, (1953). The Tax Court has shown that the rules in the two types of cases can co-exist in harmony with each other, and the consistency of its decisions emphatically underscores the absence of conflict and the lack of any basis for review.

Petitioner misreads the opinion of the court below when he asserts that it presents a conflict as to the interpretation to be given to the decision of this Court in *Eisner* v. *Macomber,* 252 U.S. 189 (1920). The court below fully rec-

ognized that the definition of income, expressed in *Eisner* v. *Macomber,* can not be applied with wooden rigidity and that it should be accepted only as a guide. Thus the court said:

> "• • • Of course, as the United States points out, in *Eisner* v. *Macomber* the Supreme Court was primarily concerned with distinguishing between capital and income, not between sources of property which came into the hands of the taxpayer and we cannot doubt but that the Supreme Court has departed in some degree from the *Eisner* v. *Macomber* definition. This is apparent from *United States* v. *Kirby Lumber Co.,* 284 U.S. 1, 3 (1931) where Mr. Justice Holmes stated: 'We see nothing to be gained by the discussion of judicial definitions.' " (App. 38a)
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> • • •
>
> "• • • We concede that no definition is too helpful, *United States* v. *Kirby Lumber Co., supra,* and that the decisions relating to income tax law contain charts rather than definitions, as Mr. Mertens has aptly stated. But it should be borne in mind that in *Eisner* v. *Macomber,* albeit where severability was the primary issue, the Supreme Court said, 252 U.S. at pp. 206-207, that 'only a clear definition of the term "income" as used in common speech • • •' was required. We do believe that a 'windfall'—and the payments at bar were 'windfalls'— would not be regarded as 'income' within the terms of common speech. Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor. We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him. This is perhaps an oversimplification but we are of the opinion that the ordinary man using terms of common speech would not regard punitive damages as 'income.' " (App. 43a-44a)

Far from evoking a conflict with the interpretation given to *Eisner* v. *Macomber* by the Court of Appeals for the

Second Circuit, this language is a striking counterpart of the following expression by that court in the *General American Investors Co., Inc.* case:

> "Is there some common principle or touchstone by the application of which one may infallibly determine what is and what is not in a given case 'gains or profits and income derived from any source whatever'? We think not. The old definition of *Eisner* v. *Macomber* was perhaps contrived in the hope that a final and definitive solution had been found. But by reason of the very nature of the subject matter this was not to be. The decision in *Eisner* v. *Macomber* still stands, but the definition has met the common fate of generalities, and it has long since given way to an empirical case by case approach, which has the virtue of elasticity and makes possible a more sensible solution of new problems as they arise." (211 F. 2d at 523)

Thus, both courts disavowed a slavish adherence to an inflexible definition of income and expressed complete agreement in their views as to the interpretation and weight to be given to the *Eisner* v. *Macomber* formula. Similarly, the court below expressly recognized that in *Eisner* v. *Macomber*, a stock dividend case, severability or realization of income was the primary issue, and accordingly the decision below is in harmony with the views of the Court of Claims in *Park & Tilford Distillers Corp.*, where *Eisner* v. *Macomber* was distinguished on that ground.

Petitioner cites a number of decisions of this Court in an endeavor to show what it regards as a departure from the *Eisner* v. *Macomber* definition of income. Since the court below did not place undue reliance upon that definition, petitioner's argument is without weight. None of the cases cited by petitioner involved the taxability of punitive damages or any other receipt of a similar nature, and the

decision below is not in conflict with the holdings or the principles of those cases.

Thus in *Rutkin* v. *United States,* 343 U.S. 130 (1952), it was held that money obtained by extortion is taxable income. The case establishes the principle, without applicability here, that the reach of the taxing statute is not confined to legitimate earnings but extends as well to gains derived by a person from an unlawful enterprise.

*United States* v. *Safety Car Heating & Lighting Co.,* 297 U.S. 88 (1936), holds that the recovery of lost profits arising out of a patent infringement is taxable income. The theory, of course, is that if the taxpayer had not been wronged, it would have earned the profits in its own business and paid a tax thereon. The recovery, being compensatory, takes the nature of the income which it replaces and is subject to tax. No such reasoning can be applied to the recovery of punitive damages.

*Helvering* v. *Bruun,* 309 U.S. 461 (1940), decided that a building erected by a tenant constituted a taxable gain to the lessor upon the forfeiture of the leasehold. The lease provided that all buildings erected would be surrendered to the lessor, and accordingly, the gain realized by the lessor was in the nature of rent. Section 22(a) of the Internal Revenue Code specifically includes rent within the statutory definition of gross income.

In *Douglas* v. *Willcuts,* 296 U.S. 1 (1935), trust income paid to the taxpayer's wife in discharge of his obligation to pay alimony was held to be taxable income of the taxpayer. The receipt in question was admittedly income, and the case merely involved the question of the person upon whom the tax should fall.

*United States* v. *Kirby Lumber Co.,* 284 U.S. 1 (1931) is similarly inapposite. The Court held that the purchase

by a corporation of its own bonds at less than the issuing price resulted in a realization of taxable income to the corporation. Provisions of the Treasury Regulations, which had been in effect during repeated re-enactments of the statutory definition of gross income, were relied upon.

The cases of *Taft* v. *Bowers,* 278 U.S. 470 (1929), and *Cooper* v. *United States,* 280 U.S. 409 (1930), both held that a donee, upon the sale of stock received as a gift, is taxable on the full amount of the difference between the ultimate sales price and the original cost of the stock to the donor.

None of the foregoing decisions involved punitive damages or point to a result contrary to that reached by the court below. The Court of Appeals carefully followed the applicable decisions of this Court and adhered as well to the long-standing provisions of the Treasury Regulations. There is no conflict between the decision below and that of any other court and no basis exists for further review.

## II.

**The question decided below is not of sufficient importance to warrant further review by this Court.**

There being no conflict between the decision below and that of any other court, there are no considerations present which clothe this case with an importance superior to that of other tax cases decided daily in the federal courts. In the entire period since the adoption of the Sixteenth Amendment in 1913 until 1952, only two reported cases have arisen involving the taxability of punitive damages. The first was *Highland Farms Corp.* v. *Commissioner,* 42 B.T.A. 1314, decided in 1940, and the second is the instant case. The four additional pending cases cited by the petitioner leave the total less than impressive. Since

the decisions in all of these cases are in accord, there is no danger of confusion in the administration of the revenue laws nor occasion for further litigation.

The Court of Appeals carefully confined its ruling to the precise issue before it. By assuming an impact beyond that limitation, petitioner reads into the opinion below an unwarranted significance on the whole area of taxable income. The express restraint of the unanimous opinion below renders that contention wholly inadmissible. Moreover, petitioner's view is inconsistent with that taken by the Government in its brief in opposition to the granting of the writ in *Park & Tilford Distillers Corporation* v. *United States,* certiorari denied, 345 U.S. 917 (1953). The conclusion in that brief states that "the petition for writ of certiorari presents no question of importance warranting review."

## III.

**The rule of the decision below is clearly correct and should not be retroactively changed.**

**A. The decision below is in conformity with the decisions of this Court.**

The decision below was unanimously reached by six Judges sitting *en banc.* The opinion carefully analyzes and follows the decisions of this Court dealing with the nature of taxable income. A brief review of those decisions will disclose that the Court of Appeals followed established principles and that its decision is clearly correct.

In *Stratton's Independence, Limited* v. *Howbert,* 231 U.S. 399 (1913), this Court, in construing the Corporation Tax Act of 1909, stated in part as follows:

> "• • • for 'income' may be defined as the gain derived from capital, from labor, or from both combined, • • •" (at 415)

This concept of income was reiterated in *Doyle* v. *Mitchell Brothers Company*, 247 U.S. 179, 185 (1918), decided under the same statute.

Following the adoption of the Sixteenth Amendment, the Income Tax Act of 1913 was enacted and in *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330 (1918), the Court said:

> "Certainly the term 'income' has no broader meaning in the 1913 Act than in that of 1909 (see *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 416, 417), and for the present purpose we assume there is no difference in its meaning as used in the two acts." (at 335)

It was with this background that *Eisner* v. *Macomber*, 252 U.S. 189 (1920) was decided. The Court, in expressing what it considered to be "a clear definition of the term 'income' as used in common speech" said:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined', provided it be understood to include profit gained through a sale or conversion of capital assets * * *" (at 207)

Following *Eisner* v. *Macomber*, the Court made clear that the concept of income expressed in that case had been consciously adopted as representing the commonly understood meaning of the term at the time of the ratification of the Sixteenth Amendment. Thus in *Merchants' Loan & Trust Company* v. *Smietanka*, 255 U.S. 509 (1921), the Court said:

> "In determining the definition of the word 'income' thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution." (at 519)

Similarly, in *United States* v. *Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99 (1936), the Court said that the term "income" should be given the meaning "as the word is known in the common speech of men."

As recently as 1949, the *Eisner* v. *Macomber* test of income was applied by this Court in determining whether members of a family had received taxable income under a family partnership agreement. In *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949), the Court said:

> "Furthermore, our decision in *Commissioner* v. *Tower, supra,* clearly indicates the importance of participation in the business by the partners during the tax year. We there said that a partnership is created 'when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.' Id. at 286. *This is, after all, but the application of an often iterated definition of income—the gain derived from capital, from labor, or from both combined—to a particular form of business organization. A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services.*" (at 740) (Emphasis supplied)

Other leading examples confirming the validity of the *Eisner* v. *Macomber* concept of income are *Taft* v. *Bowers*, 278 U.S. 470, 481 (1929); *Bowers* v. *Kerbaugh-Empire Company*, 271 U.S. 170, 174 (1926); *Edwards* v. *Cuba Railroad Co.*, 268 U.S. 628, 633 (1925); *Goodrich* v. *Edwards*, 255 U.S. 527, 535 (1921).

In holding that punitive damages do not constitute taxable income, the court below faithfully adhered to the principles established by this Court in the foregoing decisions. The definition of income, as expressed in *Eisner* v. *Macomber*, was used, not as a conclusive prescription,

but as a helpful guide. Appropriate regard was also given to the test of common usage in determining the meaning of the term "income." That term, the court correctly found, does not include the extraordinary item of punitive damage awards.

**B. The rule that punitive damages are not taxable should not be retroactively changed.**

At the time that respondent settled its litigation with Hartford-Empire Co., the Board of Tax Appeals had ruled that punitive damages did not constitute taxable income. Moreover, the Treasury Regulations for many years had provided as follows:

> "• • • In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets • • •" (Reg. 111, Sec. 29.22(a)-1)

This definition of income, which petitioner now seeks to discard, was taken from *Eisner* v. *Macomber* and has continuously remained in the Treasury Regulations throughout repeated re-enactment by Congress of the income tax statutes. Under these circumstances, respondent was entitled to rely upon that rule of law in negotiating its settlement with Hartford. The non-taxability of a portion of the settlement payment was a proper factor for the respondent to consider in its decision to compromise claims fairly valued at over $1,500,000 for a substantially lesser amount. (App. 10a, 14a)

Where a rule of tax law has been in effect for many years without any doubt ever having been cast upon its correctness and with the governing statute having been repeatedly re-enacted by Congress, there is ample precedent for holding that the harsh and oppressive conse-

quences of a retroactive reversal should not be visited upon a taxpayer in the absence of express legislative direction.

Thus, in a case involving the taxability of life insurance proceeds, this Court stated that the popular conception of non-taxability was sufficently compelling to dissuade it from changing the rule without an express legislative command. In *United States* v. *Supplee-Biddle Hardware Co.*, 265 U.S. 189 (1924) the Court said:

> "Assuming without deciding that Congress could call the proceeds of such indemnity, income, and validly tax it as such, we think that in view of the popular conception of the life insurance as resulting in a single addition of a total sum to the resources of the beneficiary, and not in a periodical return, such a purpose on its part should be express, as it certainly is not here." (at 195)

In *Lilly* v. *Commissioner*, 343 U.S. 90 (1952), the Court held that it was unwarranted to disallow deductions on the ground that the payments in question violated public policy since in the taxable years there was no governmentally declared public policy proscribing such payments. The Court refused to give effect to State legislation adopted subsequent to the taxable years on the express ground that to do so would work a retroactive hardship.

Also directly in point is *Fondren* v. *Commissioner*, 324 U.S. 18 (1945). In that case the question was whether certain gifts constituted gifts of future interests within the meaning of the gift tax statute. A Treasury Regulation promulgated prior to the re-enactment of the statute by the Congress was held to be controlling. The Court said:

> "The regulation has received the construction now reaffirmed with substantial consistency. The statute,

with the meaning thus settled, has been reenacted by Congress. The construction should be followed until Congress sees fit to change it." (at 29-30)

The tax treatment of alimony payments also presents a forceful analogy. For many years the courts held such payments to be non-taxable until a specific change in the Internal Revenue Code was made to cover them. In *Gould* v. *Gould,* 245 U.S. 151 (1917), this Court, in holding that alimony was not taxable to the recipient prior to the change in the statute, said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen." (at 153)

If, as has always been understood, the settlement of litigation is to be fostered and encouraged, a taxpayer who has acted in furtherance of that objective should not be penalized by the unexpected imposition of a heavy tax burden. The decision of the court below does not operate retroactively to reverse a rule upon which respondent had every justification to rely. In the absence of legislative action that rule should not be changed.

## CONCLUSION.

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari to the United States Court of Appeals for the Third Circuit should be denied.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

**October Term, 1954.**

**No. 199.**

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

GLENSHAW GLASS COMPANY

---

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

WILLIAM GOLDMAN THEATRES, INC.

---

## BRIEF OF RESPONDENT, WILLIAM GOLDMAN THEATRES, INC., IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

---

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COMMISSIONER OF INTERNAL REVENUE,
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WILLIAM GOLDMAN THEATRES, INC.

## BRIEF OF RESPONDENT, WILLIAM GOLDMAN THEATRES, INC., IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

### QUESTION PRESENTED.

Did respondent's receipt of punitive damages pursuant to Section 4 of the Clayton Act (15 U. S. C. § 15) constitute taxable income?

## ARGUMENT.

Respondent, William Goldman Theatres, Inc., adopts the arguments in opposition to the petition for a writ of certiorari which have been made in the brief filed by respondent, Glenshaw Glass Company.

It is desired, however, to emphasize the following:

1. There is no conflict in the decisions. No court has held that the punitive portion of a treble damage award under the federal anti-trust laws is taxable as income under Section 22(a) of the Internal Revenue Code. Conversely, every court which has considered the question has held that the recovery of profits, whether by virtue of Section 16(b) of the Securities Exchange Act of 1934 (15 U. S. C. § 78p) or otherwise, is taxable as income under Section 22(a).

The analogy of *Park & Tilford Distillers Corp. v. United States*, 107 F. Supp. 941 (Ct. Cl., 1952), certiorari denied 345 U. S. 917 (1953), and *General American Investors Company v. Commissioner*, 211 F. 2d 522 (C. A. 2d, 1954) (petition for certiorari pending, No. 114) is to that portion of the respondent's recovery in the anti-trust proceeding which compensated it for lost profits, and which the respondent never denied was taxable income. As the Commissioner has stated in his Memorandum filed in the *General American Investors* case (p. 1), the question there "is whether the profits of insiders . . . which were recovered by the taxpayer . . . constitute income to the taxpayer under Section 22(a) of the Internal Revenue Code (26 U. S. C. 22)."

Section 16(b) does not provide for punitive damages. Rather it provides that in order to prevent "the unfair use of information which may have been obtained . . . [by an insider] . . . by reason of his relationship to the issuer, any profit realized . . . shall inure to and be recoverable by the issuer . . .." As a matter of legislative policy, the insider having access to information

belonging to the corporation is treated in the situations specified as having traded upon that information, and any profits which he realizes are recoverable by the corporation. Within the definition of income of *Eisner v. Macomber*, 252 U. S. 189 (1920), they have been derived from information belonging to the corporation and thus from its "capital". The recovery is taxed to the corporation just as the *profits* recovered by the respondent in the anti-trust proceeding are admittedly taxable to it. *United States v. Safety Car Heating & Lighting Co.*, 297 U. S. 88 (1936).

2. The decision below presents no departure or variation from the prior decisions of this Court. In each of the several cases cited by petitioner, the receipt which was held to be income had come from a business or property transaction or from earnings in the ordinary sense, or (as in the case of lost profits) it had been received as compensation for the loss of one of these.[1] The only case in which, as in the case at bar, this was not true was *Gould v. Gould*, 245 U. S. 151 (1917). There, the Court held that alimony payments were not income under the gross income provision of the law then in effect, corresponding o the present Section 22(a).[2] Whether such receipts, which

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1. *Rutkin v. United States*, 343 U. S. 130 (1952), represented *earnings*, although illegally obtained; *United States v. Safety Car Heating Co.*, 297 U. S. 88 (1936), involved the recovery of lost profits; *Helvering v. Bruun*, 309 U. S. 461 (1940), involved a gain resulting from a business and property transaction; *Douglas v. Willcuts*, 296 U. S. 1 (1935), merely involved the question of *to whom* a receipt which was admittedly income was to be taxed; *United States v. Kirby Lumber Co.*, 284 U. S. 1 (1931), like the *Bruun* case, involved a realization from a business and property transaction which was covered explicitly by long standing Treasury Regulations. *Taft v. Bowers*, 278 U. S. 470 (1929), and *Cooper v. United States*, 280 U. S. 409 (1930), involved questions of *basis;* the receipts involved were clearly from property transactions, and the decisions are indeed far afield from the question here involved. See *Glenshaw Glass Co.* brief, pp. 11-13.

2. The statute involved in the *Gould* case was the Income Tax Act of October 3, 1913, c. 16, Sec. II, 38 Stat. 114, 166.

were not derived from capital or labor, should be taxed to the recipient was left to specific action by the Congress.[3] Similarly, a determination whether, in what years, or to what extent an anti-trust punitive damage award should be subjected to tax involves considerations which can best be presented and evaluated through the legislative process.

Although the anti-trust laws were on the books in 1913 when the present income tax laws were first enacted; although the rule that a penalty is not income was enunciated nineteen years ago in *Central R. Co. v. Commissioner*, 79 F. 2d 697 (C. A. 3d, 1935); and although *Highland Farms Corp. v. Commissioner*, 42 B. T. A. 1314 (1940), was decided fourteen years ago, Congress has never adopted the simple amendment which is necessary to include punitive damages among the specific items of gain enumerated in Section 22(a). This remains true even today following the extensive revision of the income tax laws which has just been completed by the Congress (H. R. 8300, 83d Cong. 2d Sess.).

This legislative history indicates an absence of Congressional dissatisfaction with the result reached by the courts below. Particularly in the absence of any conflict among the decisions, it supports the view that any change should stem from Congressional consideration rather than from further judicial review.

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3. In the amendments made to the Internal Revenue Code in 1942, Congress included Section 22(k) (26 U. S. C. 22(k)), which provided for the taxation of alimony to the recipient in certain specified and limited circumstances. In all other circumstances, the receipt of alimony continues to be free from tax in accordance with the *Gould* decision. See Treas. Reg. 111, Sec. 29.22(k)-1.

## CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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August 6, 1954.

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IN THE

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*Respondent.*

## BRIEF FOR RESPONDENT, GLENSHAW GLASS COMPANY.

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COMMISSIONER OF INTERNAL REVENUE,
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*Respondent.*

---

## BRIEF FOR RESPONDENT, GLENSHAW GLASS COMPANY.

---

### Statement of the Case.

The taxpayer, Glenshaw Glass Company (Glenshaw), is a small manufacturer of glass bottles, with a plant located near Pittsburgh, Pennsylvania. For twenty years it experienced a struggle, in business and litigation, to free itself from a monopolistic and fraudulent patent yoke that Hartford-Empire Company (Hartford) and the dominant glass bottle manufacturers had fastened upon the industry.

On December 15, 1947 Hartford made a settlement payment to Glenshaw of some $813,000. This brought to a close the prolonged litigation in the course of which Glenshaw had been victimized by gross fraud practiced upon both the Patent Office and the Federal courts. By an injunction obtained through fraud in 1934, Hartford had effectively barred Glenshaw from using the royalty-free Glenshaw glass feeding machines. Under the whip of that injunction, Glenshaw was compelled to return to Hartford licenses, to submit to exorbitant royalties and to accept onerous restrictions upon the type and quantity of glass containers it could produce. Relief was ultimately obtained through action by this Court.[1]

The nature of the fraud, which gave rise to the punitive damage payment under scrutiny in this case, was described by this Court as follows:

> "Every element of the fraud here disclosed demands the exercise of the historic power of equity to set aside fraudulently begotten judgments. This is not simply a case of a judgment obtained with the aid of a witness who, on the basis of after-discovered evidence, is believed possibly to have been guilty of perjury. Here, even if we consider nothing but Hartford's sworn admissions, we find a deliberately planned and carefully executed scheme to defraud not only the Patent Office but the Circuit Court of Appeals." (322 U.S. at 245-6)

In requiring that, apart from compensatory damages, Glenshaw be awarded substantial punitive damages by reason of this fraud, the Court of Appeals for the Third Circuit said:

> "The seriousness, the long duration and the aggravated character of the fraud which has neces-

[1] *Shawkee Manufacturing Co.* v. *Hartford-Empire Co.*, 322 U.S. 271 (1944) and *Hazel-Atlas Glass Co.* v. *Hartford-Empire Company*, 322 U.S. 238 (1944).

> sitated this litigation is set forth in the cited opinions of the Supreme Court. In those circumstances, the trial court has power to inflict such damages, 'having in view the enormity of * * * [the] offense rather than the measure of compensation. * * *' *Denver & Rio Grande Ry.* v. *Harris,* 122 U.S. 597, 609."[2]

The Court of Appeals then directed the District Court to assess punitive damages "taking into consideration the whole wretched scheme." By reason of that opinion, Hartford made its settlement, and the Tax Court determined that, of the amount paid, $324,529.95 was attributable to punitive damages and represented neither replacement of property nor compensation for lost profits or expense. The allocation was accepted by the petitioner in the court below and is not in issue here.

The Tax Court held that so much of the settlement as was equated with compensatory damages was subject to tax as ordinary income and that the payment in lieu of punitive damages did not constitute taxable income under the income tax provisions of the Internal Revenue Code.[3]

The Court of Appeals for the Third Circuit heard this case and the companion *Goldman* case, *en banc.* In a unanimous opinion written by Chief Judge Biggs, the decision of the Tax Court was affirmed.[4]

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[2] *Hartford-Empire Co.* v. *Shawkee Mfg. Co.,* 163 F. 2d 474, 480 (3rd Cir., 1947).

[3] *Glenshaw Glass Co.* v. *Commissioner,* 18 T.C. 860 (1952), (R. 7-20).

[4] *Commissioner* v. *Glenshaw Glass Co.,* 211 F. 2d 928 (1954), (R. 31-7).

## Summary of Argument.

The constitutional power of the Congress to tax penalties and punitive damages is not challenged. The issue is whether such awards constitute income as contemplated by the taxing statute.

We read the income tax statute as providing for a levy upon receipts which, in ordinary usage, are regarded as income. That is what this Court said in *Eisner* v. *Macomber* and in every decision touching the subject since then. The primary characteristic of income, as ordinarily understood, is that it is a profit or compensation derived from investment or labor. This generic concept has broad implications, and we do not by its statement suggest any rigidity of application. But this Court has never departed from that generic concept, and the Congress has repeatedly enacted new and revised income tax statutes in the light of such judicial construction. The new Code adopted in 1954 is particularly instructive on the legislative acceptance of that concept of income.

Punitive damages represent a penalty imposed upon a wrongdoer as a matter of law but paid to the victim rather than to the public treasury. They stand apart from compensatory awards which are designed to make good actual losses of profit or property. They are in the nature of a windfall rather than a yield upon labor or capital and accordingly fall outside the commonly accepted concept of income.

Petitioner sees the statute not as a tax on income but as an excise tax on "gains". The latter term is lifted out of context in the statutory definition, to which the Congress has adhered for a quarter of a century fully aware of the ordinary notion of income adopted by the courts. The contention—never made in either of the

courts below—that the statute imposes not a tax on income but an excise tax on "gains" has neither statutory nor judicial support. Nor do any of the cases sustain the argument that the basic concept of income of *Eisner* v. *Macomber* has been discarded.

The rule that punitive damages do not constitute taxable income has prevailed since 1935. The principles upon which the rule was predicated have continued vitality. Any change in a rule of such long duration should be left to the Congress, which has shown a constant alertness to the amendment of the Code whenever it found itself differing with judicial construction. The emotional argument that the recipient of a windfall is best able to pay an income tax should be addressed to the Congress and not to the courts.

## Argument.

### I. Punitive Damages Do Not Constitute Taxable Income Under Section 22(a) of the Internal Revenue Code of 1939.

The answer to this case is to be found in the nature and distinguishing characteristics of punitive damages on one hand and the historical concept of income as developed by the courts and the Congress on the other. We do not urge, nor did the Court below adopt, any narrow, wooden adherence to language either in the statute or in any reported decision.

We take the statutory levy for what it is—an income tax. The petitioner insists that it is an excise tax upon all "gains", and accordingly the normal concept of income is of no concern. This effort to expand the tax so as to reach "any increase in resources"[5] runs counter to a half a century of decisions that income must be given its ordinary meaning.

A. *Historical concept of income.*

Following the adoption of the Sixteenth Amendment, the Congress enacted the income tax provisions of the Tariff Act of October 3, 1913. (c. 16, 38 Stat. 114, 167) The definition of taxable income in that statute, which has been carried forward without substantial change into the Internal Revenue Code of 1939, was as follows:

> "That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation

[5] Pet. Br. 15.

> for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, * * *"

This Court had occasion to consider the meaning of the term "income" as used in the 1913 statute in *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330, 335 (1918). In holding that dividends declared out of pre-1913 earnings did not constitute taxable income to the recipient, the Court rejected "the broad contention submitted in behalf of the Government that all receipts—everything that comes in—are income within the proper definition of the term 'gross income.'"

It was against this background that *Eisner* v. *Macomber*, 252 U.S. 189 (1920), was decided. The statute under review was the Revenue Act of 1916 which followed the definition of net income in the 1913 Act with the addition of express inclusion of stock dividends. In reaching the conclusion that the particular stock dividends did not give rise to the realization of taxable income within the meaning of the Sixteenth Amendment, the Court carefully re-examined the concept of income:

> "For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.
>
> "After examining dictionaries in common use (Bouv. L.D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the

> succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle* Case (pp. 183, 185)." (at 206-7) (Emphasis supplied.)

In enacting the Revenue Act of 1921 the Congress took note of *Eisner* v. *Macomber*, attributing to that decision the determination to remove from the Act the provision to tax stock dividends.[6] Cognizant of the basic concept of income developed by this Court, the Congress made no change in the statutory definition. Significantly enough, the Congress has never in more than twenty extensive revisions of the income tax law sought to expand the meaning of income beyond the everyday notion adopted by this Court.

The Internal Revenue Code of 1954, adopted after the decisions by the courts below, shows no intent to reach punitive damages either by an express provision or otherwise.[7]

No decision of this Court inconsistent with *Eisner* v. *Macomber* can be cited. On the contrary, that expression of the characteristic attributes of income subject to tax has been approved or applied by this Court on frequent occasions. *Merchants' Loan & Trust*

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[6] H. Rep. No. 350 and S. Rep. No. 275, 67th Cong., 1st Sess. (1921).

[7] The revision, designed by the Congress to clarify and not to change the meaning of "gross income", effectively answers the petitioner's contention that all gains are income. See *infra*, pp. 14-15.

*Co.* v. *Smietanka,* 255 U. S. 509, 519 (1921); *Goodrich* v. *Edwards,* 255 U. S. 527 (1921); *U. S.* v. *Phellis,* 257 U. S. 156 (1921); *Weiss* v. *Stearn,* 265 U. S. 242 (1924); *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 174 (1926); *Taft* v. *Bowers,* 278 U. S. 470 (1929); *U. S.* v. *Safety Car Heating & Lighting Co.,* 297 U. S. 88, 99 (1936); *Commissioner* v. *Culbertson,* 337 U. S. 733, 740 (1949).[8]

The meaning of income, this Court thought in *Eisner* v. *Macomber,* was to be derived from ordinary usage. The very next year, this Court repeated its refusal "to enter into the refinements of lexicographers or economists" and turned instead to "the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."[9]

The precise definition of *Eisner* v. *Macomber* was repeated in *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 174 (1926). Finding a discussion of judicial definitions unnecessary, Justice Holmes held in 1931 that the difference between the amount which a corporation received when it issued its bonds and the price it paid when it repurchased them constituted income "if we take words in their plain popular meaning, as they should be taken here".[10] Similarly, in *United States* v. *Safety Car Heating & Lighting Co.,* 297 U. S. 88, 99 (1936), this Court said that the term "income" should be given the meaning "as the word is known in the common speech of men."

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[8] In *Helvering* v. *Griffiths,* 318 U.S. 371 (1943), this Court expressly refused to overrule *Eisner* v. *Macomber.*

[9] *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U.S. 509, 519 (1921).

[10] *U. S.* v. *Kirby Lumber Co.,* 284 U.S. 1, 3 (1931).

As recently as 1949, the *Eisner* v. *Macomber* test of income was expressly applied in determining whether members of a family had received taxable income under a family partnership agreement. In *Commissioner* v. *Culbertson,* 337 U. S. 733 (1939), the Court cited *Eisner* v. *Macomber,* saying:

> "Furthermore, our decision in *Commissioner* v. *Tower, supra,* clearly indicates the importance of participation in the business by the partners during the tax year. We there said that a partnership is created 'when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.' *Id.* at 286. This is, after all, but the application of an often iterated definition of income—the gain derived from capital, from labor, or from both combined—to a particular form of business organization. A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services." (at 740) (Emphasis supplied)

There has thus been consistent judicial and legislative acceptance of the basic concept of income. Both avenues lead to the conclusion that gross income subject to tax by Section 22(a) does not extend to "every increase in resources" as petitioner has found it necessary to insist.[11]

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[11] Since 1922, the Treasury Regulations, in defining gross income, have consistently incorporated the historic definition of *Eisner* v. *Macomber.* U. S. Treas. Regs. 62, Art. 31 and U. S. Treas. Regs. 111, Sec. 29.22(a)-1. The broad language used to define income elsewhere in the Regulations was apparently regarded as inadequate to express the content of the term "gross income" without further clarification and specificity.

B. *Nature of punitive damages.*

Punitive damages have been designed by the courts as a penal sanction to deter wrongdoers. In effect a fine is imposed, but by the grace of the sovereign, payment is made to the injured party rather than to the public treasury. The same policy has been adopted by legislative practice with respect to anti-trust and other penalties.

As this Court put it in the early case of *Lake Shore & Michigan Southern Railway Co.* v. *Prentice*, 147 U. S. 101, 107 (1893), punitive damages are an award "not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others." The Pennsylvania law under which the punitive damage payment to Glenshaw was made is similarly stated in *Thompson* v. *Swank*, 176 Atl. 211 (Pa., 1934):

> "Where the injurious act is willful, malicious, or wanton, the jury, according to the malignity shown, without bias or feeling, may award a reasonable sum in vindication of the rights of the injured party as exemplary or punitive damages. By so doing they tend to prevent the wrongdoer and others from committing similar acts." (at 211)

While the extent of the harm may be taken into account in determining the magnitude of punitive damages, it is not essential to the recovery of punitive damages that the plaintiff should have suffered any harm, either pecuniary or physical.[12] The petitioner suggests that "in a loose sense", the punitive damage payment was derived from Glenshaw's business, or at least from the capital and labor involved in prosecuting the litigation. The first aspect is a typical "but for" argument. Obviously, if Glenshaw had not engaged in business, it could not have been victimized by Hartford, and hence, no right of action

[12] 4 Restatement, Torts, § 908, Comment c, pp. 555-6.

either for compensatory or punitive damages would have arisen. But that falls far short of the notion that Glenshaw's business produced the penalty payment. Nor can it be fairly said that the punitive damages stem from the litigation. The right to punitive damages arose when the gross fraud was perpetrated. The litigation served simply to collect the punitive damages. That litigation no more produced the punitive damages than does a suit to collect a debt produce the amount due. As Chief Judge Biggs concluded, "Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor." (R. 37)

The opinion below provides an informative analysis of punitive damages in the present context:

> "Punitive damages seem to be *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear they do not fall within the definition of *Eisner* v. *Macomber* and if we could be certain that the definition of that case was controlling we would have no difficulty with the issue at bar. It is easy to say what punitive damages are not but difficult to say what they really are. They smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo*. An analogy seems to us to lie in those cases where contributions are made by the sovereign in the general public interest to an individual. Cf. *Edwards* v. *Cuba Railroad Company*, *supra*. Where the injuries were gross, the doctrine of punitive damages come into play. The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are

> naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer." (R. 36)

The Court of Appeals regarded punitive damages and antitrust penalties as "windfalls", and in this respect the Seventh Circuit did not disagree.[13] Admittedly such payments are not the fruit of either labor or capital but are obtained by the recipient because he had been the victim of grave misconduct. They are capital contributions by process of law.

C. *Punitive damages and penalties are not taxable income.*

Unless punitive damages come within the basic theory of income, they cannot be subjected to the income tax. This approach was first taken by the Court of Appeals for the Third Circuit in 1935. *Central R. Co. of New Jersey* v *Commissioner*, 79 F. 2d 697 (3rd Cir., 1935) held that a penalty imposed by law upon a faithless fiduciary did not constitute taxable income t the corporate recipient. The Court there adopted the ordinary usage of the term income which had already been endorsed by this Court in a number of cases. The next decision was *Highland Farms Corp.* v. *Commissioner of Internal Revenue*, 42 B.T.A. 1314 (1940). That case held that an award of punitive damages did not constitute taxable income. No appeal was prosecuted. No change was made in the taxing statutes nor in the Treasury Regulations to repudiate or modify the principle applied in these cases.

It was this well established rule to which the Tax Court and the Court of Appeals adhered in the present proceeding. That the primary characteristic of income, as that term is ordinarily understood, is compensation for services

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[13] *Commissioner* v. *Obear-Nester Glass Co.*, ..... F. 2d ..... (7th Cir., 1954), pending on petition for certiorari as No. 478.

or profits from property or business transactions is not seriously challenged by the petitioner. Nor does he deny periodicity as a frequent attribute of income. Indeed, petitioner's brief does not concern itself with the nature or characteristics of income. The controlling term, according to the petitioner, is not "income" but "gain".[14] The "foundation" of petitioner's position is that every increase in resources is a gain, and every gain is taxable.[15]

Section 22(a) describes gross income as "gains, profits and income" derived from (1) personal or professional services, (2) ownership or use of property or capital, (3) conduct of a trade or business, and (4) "gains or profits and income derived from any source whatever." Two things seem evident in this definition. The first quoted phrase shows a purpose, by repetition, to reach income in any form, and the closing phrase was obviously designed to assure a liberal and hospitable understanding of the previously recited categories of income. But what is basic is the statutory purpose to develop the meaning of income. It could hardly have been intended to destroy and wipe out that fundamental concept. Yet that is the very purport of petitioner's lifting the single word "gain" out of the final phrase and contending that all gains, whatever their nature or source, constitute taxable income. Had the Congress intended to tax all increases in resources rather than income, it would have been easy to say just that in the statute. It would have been wholly unnecessary either to mention income or to undertake a detailed definition of the term.

The revision of Section 22(a) in the Internal Revenue Code of 1954 throws new light on the weakness of petitioner's entire position. The new Code reflects a desire to

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[14] Pet. Br. 11.

[15] Pet. Br. 15.

clarify and simplify the definition of gross income without changing its meaning. To that end, Section 61(a) provides:

> "(a) GENERAL DEFINITION. — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: (1) Compensation for services, including fees, commissions, and similar items; (2) Gross income derived from business; (3) Gains derived from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Alimony and separate maintenance payments; (9) Annuities; (10) Income from life insurance and endowment contracts; (11) Pensions; (12) Income from discharge of indebtedness; (13) Distributive share of partnership gross income; (14) Income in respect of a decedent; and (15) Income from an interest in an estate or trust."

The House Ways and Means Committee pointed out that "While the language in existing section 22(a) has been simplified, the all-inclusive nature of statutory gross income has not been affected thereby. Section 61(a) is as broad in scope as section 22(a)." Similarly, the Senate Committee on Finance noted that Section 61(a) "is not intended to change the concept of income that obtains under section 22(a)."[16]

By this simplification, Congress recognized that the term "income" has an accepted, known concept. The repetitious words "gain" and "profits" were eliminated from the primary statement of the definition, and the entire catch-all phrase "gains or profits and income derived from any source whatever" was dropped. This clarification reflects not merely a prospective purpose but an historical intent. It undermines what the petitioner has characterized as the "foundation" of his argument—that the controlling term is "gain" rather than "income."

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[16] H. Rep. No. 1337, p. A18, 83rd Cong., 2d Sess. and S. Rep. No. 1622, p. 168, 83rd Cong., 2d Sess.

The reference in the 1939 Code to "gains" was not new. It was in the statute when *Eisner* v. *Macomber* was decided. It remained in the statute without significant change throughout the years and has been paralleled by consistent decisions adhering to the basic concept of income. In no decision and in no administrative ruling has the idea that every increase in resources is taxable income heretofore been suggested.

What Congress was endeavoring to do in Sec. 22(a) was perfectly clear to this Court in *Helvering* v. *Clifford*, 309 U.S. 331, 334 (1940), when it said:

> "The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories." (Emphasis supplied)[17]

Obviously, "economic gain is not always taxable income."[18] In a long list of categories, gains not specifically exempted and unrelated to the restoration of capital have been excluded from taxable income. Among these are:

1. Alimony. *Gould* v. *Gould*, 245 U.S. 151 (1917).
2. Insurance proceeds. *U. S.* v. *Supplee-Biddle Co.*, 265 U.S. 189 (1924).
3. Subsidy payments for capital investment. *Edwards* v. *Cuba Railroad Co.*, 268 U.S. 628 (1925).
4. Community contribution to induce location of a plant. *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583 (1950).
5. Forfeiture of stock subscriptions upon non-payment of other deferred installments. *Commissioner* v. *Inland Finance Co.*, 63 F. 2d 886 (9th Cir., 1933).

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[17] Six years later, this statement was quoted with approval in *Commissioner* v. *Wilcox*, 327 U.S. 404, 407 (1946).

[18] *Helvering* v. *Bruun*, 309 U.S. 461 (1940).

6. Recovery for libel *per se*, without special damages. *C. A. Hawkins* v. *Commissioner*, 6 B.T.A. 1023 (1927); also *MacDonald* v. *Commissioner*, 9 B.T.A. 1340 (1928), where damages recovered for breach of promise to marry were held non-taxable.
7. Board and lodging received by an employe, when furnished for the convenience of the employer. Reg. 118, Sec. 39.22(a)-3.

The exclusion of these gains demonstrates that the meaning of taxable income is to be found not in the superficial test of economic gain but in the rational concept to which *Eisner* v. *Macomber* gave practical expression. An examination of some of the authorities falling within the foregoing categories yields further guides in its application.

*Gould* v. *Gould*, 245 U.S. 151 (1917), established two significant principles: (1) despite the general language of Section 22(a), Congresss did not intend to treat all economic gains as taxable income; and (2) in interpreting "statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used," and doubts are to be resolved "most strongly against the government and in favor of the citizen."[19]

It is worthy of repetition that the definition of net income in the 1913 Act was substantially the same as Section 22(a) of the Internal Revenue Code of 1939. It contained the words "gains or profits and income derived from any source whatever." Yet this Court held that alimony, which is certainly a gain within the literal purview of that catch-all phrase, was not embraced by the definition of income taken as a whole.

Insurance proceeds certainly constitute an economic gain. The wealth of the recipient is augmented and generally by

[19] *Gould* v. *Gould*, 245 U.S. 151, 153 (1917).

an amount in excess of the premiums, whether paid by the decedent or the beneficiary. But the ordinary notion of income can hardly be said to embrace insurance proceeds. *U. S.* v. *Supplee-Biddle Co.*, 265 U.S. 189 (1924), involved the taxability of the proceeds of life insurance received by a corporation. In construing the statutory exemption given to an individual beneficiary as extended to a corporation despite the absence of clear language, Chief Justice Taft said:

> "* * * The benefit to be gained by death has no periodicity. It is substitution of money value for something permanently lost either in a house, a ship, or a life. Assuming without deciding that Congress could call the proceeds of such indemnity, income, and validly tax it as such, we think that in view of the popular conception of the life insurance as resulting in a single addition of a total sum to the resources of the beneficiary, and not in a periodical return, such a purpose on its part should be express, as it certainly is not here." (at 195)

D. *Contentions and authorities relied upon by petitioner.*

The contention that every accession to wealth, not specifically exempted, is taxable income rests primarily upon the assumption that *Eisner* v. *Macomber* has been scrapped by subsequent decisions. We have already seen that in a long line of decisions, this Court has utilized and given vitality to the *Eisner* v. *Macomber* notion that income is to be determined in its ordinary sense, and indeed, the specific guideposts were invoked as late as the *Culbertson* case.[20]

The specific cases cited by the petitioner yield no support for his contention. *U. S.* v. *Kirby Lumber Co.*, 284 U.S. 1 (1931), held that the purchase of bonds by the issuer at less than the par value initially received pro-

[20] *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949).

duced taxable income. This was an obvious profit arising in trade and from the use of the taxpayer's capital. The Treasury Regulations, in effect during repeated enactments of the statutory definition of gross income, had expressly covered this type of profit and were cited by the Court as a basis for its decision.

*Helvering* v. *Bruun,* 309 U.S. 461 (1940), held that a building erected by a tenant constituted a taxable gain to the lessor upon the forfeiture of the leasehold. The lease provided that all buildings erected would be surrendered to the lessor. Hence the gain was in the nature of rent. The Court said:

> "While it is true that economic gain is not always taxable as income, the forfeiture of the building was a realized gain on property in a business transaction." [21]

*Rutkin* v. *U. S.,* 343 U.S. 130 (1952), in holding that money obtained by extortion is taxable, simply established the principle, without applicabilty here, that the reach of the taxing statute is not confined to legitimate earnings but extends as well to profits from unlawful enterprises.

*Irwin* v. *Gavit,* 268 U.S. 161 (1925), merely held that income from a testamentary trust was not within the statutory exemption accorded to bequests and was taxable to a beneficiary entitled to receive the income for a period of years. This Court emphasized that the payments were income "by the common understanding of that word" and by "popular speech."

*U. S.* v. *Safety Car Heating & Lighting Co.,* 297 U.S. 88 (1936), equates recovery of lost profits in a patent infringement action with profits earned in the operation of the business. *Robertson* v. *U. S.,* 343 U.S. 711, 713

[21] 309 U.S. at 469.

(1952), construed a prize to a composer in a symphony contest as "payment for services rendered," carefully noting that there would be no taxability if an award were made "in recognition of past achievements or present ability."

Petitioner also leans upon the decisions of the Court of Claims and the Court of Appeals for the Second Circuit taxing the recovery by a corporation of short-swing profits of a fiduciary under Section 16(b) of the Securities Exchange Act of 1934.[22] There is a very sharp distinction between the windfall character of punitive damages and the profit recovery under Section 16(b). The essence of that provision of the Securities Exchange Act is that a corporate fiduciary ought not to use for his personal gain the confidential information that rightfully belongs to the corporation and all its shareholders. When profits are realized in the course of short term trading, there is a statutory presumption that those profits were derived from the inside information that belongs to the corporation. Accordingly, the fiduciary insider is required to account to the corporation for such profits. Recovery under Section 16(b) can fairly be regarded as a profit arising out of the use of a corporate asset.[23]

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[22] *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941 (Ct. Cl. 1952) cert. denied 345 U.S. 917; *General American Investors Co., Inc.* v. *Commissioner*, 211 F. 2d 522 (2nd Cir., 1954) cert. pending, No. 114.

[23] The purpose and underlying principles of Section 16(b) as described above are set out in S. Rep. 1455, pp. 55, 68, and H. Rep. No. 1383, p. 13, 73rd Cong., 2d Sess. (1934). Also see Cook and Feldman, *Insider Trading under the Securities Exchange Act* (1953) 66 Harv. L. Rev. 385, 408, where it is said of Section 16(b): "It appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is made liable to the corporation for the profits he realizes."

No court has subjected to income tax a gain not derived from labor or capital or not expressly specified in the Code except the Seventh Circuit in *Commissioner* v. *Obear-Nester Glass Co.* That case was decided after certiorari had been granted in this proceeding and is now pending on petition for certiorari, No. 478, this Term. The principal thrust of the opinion is that an individual should be taxed according to his ability to pay and that the question is, "has he realized an economic gain, from whatever source, which leaves him better able to contribute to the support of his government?" This is patently an effort judicially to fashion the tax pattern. Obviously, one receiving a huge gift is "better able to contribute to the support of his government," but that does not subject the gift to an income tax. No income tax is imposed upon the beneficiary of life insurance, even if under the Code the insurance proceeds are not even subject to the estate tax. One who obtains large capital gains is "better able" to pay a high tax than the millions of wage earners required to rely exclusively upon their earnings. Tax-free corporate distributions represent a fertile source that might be tapped by the "ability to pay" doctrine. It is for the Congress to weave the tax pattern and to choose how the burden shall be spread. It is not for the courts to select those who can best afford to pay the tax but rather to determine what statutory levy the Congress intended to impose.

That the Seventh Circuit argument should have been addressed to the Congress is highlighted by the corollary question of whether the wrongdoer should be permitted a deduction for the payment of punitive damages or penalties. Cf. *Heininger* v. *Commissioner*, 320 U.S. 467, 473 (1943). When this Court faced the problem with respect to alimony, it declined to extend the ordinary concept of income to alimony which had roots in neither labor nor capital: On the

other hand, when the Congress elected specifically to tax the receipt of periodic alimony payments, it provided a corresponding deduction to the payer.

The second argument urged by the petitioner is that the tax here under scrutiny is not an income tax under the Sixteenth Amendment but an excise levy under Article I of the Constitution. This suggestion, nowhere supported, had not been urged either before the Tax Court or the Court of Appeals. It was only when this Court granted certiorari that the petitioner discovered that the statute his office had been administering since 1913 was not a levy on income but an excise tax on gain.

We do not argue (for it is not necessary for our position) that penalties and punitive damages are outside the constitutional reach of an excise levy by the Congress without apportionment. Suffice it to say that the Congress has not enacted such excise levy but has imposed a tax upon income. This is made perfectly clear by the House Committee Report accompanying the Act of October 3, 1913. Under the caption, "Income Tax," the Committee on Ways and Means wrote:

> "Section 2 of the bill imposes a tax upon the annual net incomes of individuals and corporations. This is in response to the general demand for justice in taxation, and to the long-standing need of an elastic and productive system of revenue.
>
> "For 25 years a contest has been waged throughout the country in behalf of the adoption of a national income tax as a permanent part of our fiscal system, and the sentiment in favor of this movement finally became so strong that the people overturned a decision of the Supreme Court of the United States by writing into the Constitution the first amendment within 40 years." [24]

[24] H. Rep. No. 5, 63rd Cong., 1st Sess., (1913).

Text writers have uniformly concluded that the income tax statutes since 1913 are exercises of the power of the Congress under the Sixteenth Amendment. Magill says:

> "So far as the federal government is concerned, each income tax statute since 1913 purports to be an exercise of the power conferred upon Congress by the Sixteenth Amendment 'to lay and collect taxes on incomes, from whatever source derived.'" [25]

Mertens emphasizes that the income tax is a levy under the Sixteenth Amendment and that "the income or receipts which the statute may properly reach and tax is limited to such receipts as fall within the term 'income' as used in the Sixteenth Amendment." [26] In its decisions exploring and determining the scope of profits and receipts subject to the income tax, this Court has made frequent use of the Sixteenth Amendment but has never suggested that the levy under scrutiny had its constitutional roots in Article I. This is a new thought alien to the language and reports of the Congress and unrelated to judicial analysis.

We seek no static adherence to judicial definition. Our resort is to the fundamental concept of income. We would look to the ordinary meaning of the word and the guideposts of *Eisner* v. *Macomber* that have stood the test of time and experience. We accept the decisions of this Court as charting the general framework of income. We reject as a perversion of the statute the transformation of the levy from a tax upon income into a tax upon any receipt of money or property. That is the extreme position into which the petitioner has been driven and which he cannot sustain either by authority or rational justification.

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[25] Magill, *Taxable Income* (1945) p. 5.

[26] Mertens, *Law of Federal Income Taxation*, (1942) Sec. 1.10, pp. 22-23.

## II. The Long Standing Rule That Punitive Damages Do Not Constitute Taxable Income Should Not Be Changed Except by Legislative Action.

At the time that respondent settled its litigation with Hartford-Empire Co., the law was settled that punitive damages do not constitute taxable income.[27] The decision to that effect by the Court of Appeals for the Third Circuit in 1935 was followed by the Tax Court in *Highland Farms Corp.* v. *Commissioner,* 42 B.T.A. 1314 (1940). No review of the *Central R. Co.* case was sought in this Court. With respect to the *Highland Farms* case, the Commissioner noted non-acquiescence but took no appeal. Respondent was entitled to rely upon that undisturbed rule of law in negotiating settlement. The non-taxability of a portion of the settlement payment was a proper factor for respondent to consider in its decision to compromise claims fairly valued at over one and one-half million dollars for little more than half that amount.

Here is a rule of tax law that has been in effect for twenty years. No effort has been made to accomplish a statutory change. Under these circumstances there is ample precedent for holding that the harsh consequences of a retroactive reversal should not be visited upon a taxpayer in the absence of express legislative direction.

Petitioner argues that "on its facts" the Fifth Circuit's decision in *Arcadia Refining Co.* v. *Commissioner,* 118 F. 2d 1010 (5th Cir., 1941), was directly contrary to the *Central R. Co.* decision. That case held that the recovery of profits earned on embezzled funds represented profits from capital subject to tax; the case did not deal with the question of whether penalties or punitive damages are subject to tax.

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[27] *Central R. Co. of New Jersey* v. *Commissioner,* 79 F. 2d 697 (3rd Cir., 1935).

Similarly, the Second Circuit decisions[28] questioned whether the recovery in *Central R. Co.* should in fact have been characterized as a penalty rather than profit recovered, but did not consider whether a penalty constituted taxable income. Nor did any of the cases decided by this Court abandon the common sense approach to income upon which *Eisner* v. *Macomber* and, in turn, *Central R. Co.* were based.

In *Helvering* v. *Griffiths*, 318 U. S. 371 (1943), the Supreme Court was asked to overrule its holding in *Eisner* v. *Macomber* because of a change in the income tax law enacted in 1936. In refusing so to do the Supreme Court said:

> "We are asked to make a retroactive holding that for some seven years past a multitude of transactions have been taxable although there was no source of law from which the most cautious taxpayer could have learned of the liability. If he consulted the decisions of this Court, he learned that no such tax could be imposed; if he read the Delphic language of the Act in connection with existing decisions, it, too, assured him there was no intent to tax; if he followed the Congressional proceedings and debates, his understanding of nontaxability would be confirmed; if he asked the tax collector himself, he was bound by the Regulations of the Treasury to advise that no such liability existed. It would be a pity if taxpayers could not rely on this concurrent assurance from all three branches of the Government. But we are asked to brush all this aside and simply to decree that these transactions are taxable anyway." (at 402)

*Fondren* v. *Commissioner*, 324 U. S. 18 (1945), related to the question of whether certain future interests were gifts under the gift tax statute. A Treasury Regulation

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[28] *Sterling* v. *Commissioner*, 93 F. 2d 304 (2nd Cir. 1937) cert. denied 303 U.S. 663; *Lyeth* v. *Hoey*, 96 F. 2d 141 (2nd Cir., 1938), reversed 305 U.S. 188 (1938).

promulgated prior to the re-enactment of the statute by the Congress was held to be controlling. This Court said:

> "The regulation has received the construction now reaffirmed with substantial consistency. The statute, with the meaning thus settled, has been reenacted by Congress. The construction should be followed until Congress sees fit to change it." (at 29-30)

The tax treatment of alimony payments also presents a forceful analogy. For many years the courts held such payments to be nontaxable until a change in the Internal Revenue Code was made to cover them. In *Gould* v. *Gould*, 245 U. S. 151 (1917), the Supreme Court, holding that alimony was not taxable to the recipient prior to the change in the Code, said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen." (at 153)

If, as has always been understood, the settlement of litigation is to be fostered and encouraged as a matter of public policy, a taxpayer who has acted in furtherance of that policy should not be penalized by the unexpected imposition of a heavy tax burden.

## Conclusion.

For the foregoing reasons, it is respectfully submitted that the decision of the United States Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

October Term, 1954.

## No. 199.

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

GLENSHAW GLASS COMPANY,

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

WILLIAM GOLDMAN THEATRES, INC.

## BRIEF FOR RESPONDENT, WILLIAM GOLDMAN THEATRES, INC.

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IN THE

# Supreme Court of the United States.

OCTOBER TERM, 1954.

No. 199.

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

GLENSHAW GLASS COMPANY.

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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

WILLIAM GOLDMAN THEATRES, INC.

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## BRIEF FOR RESPONDENT, WILLIAM GOLDMAN THEATRES, INC.

### STATUTORY PROVISIONS.

CLAYTON ACT:

"SEC. 15. SUITS BY PERSONS INJURED; AMOUNT OF RECOVERY.

"Any person who shall be injured in his business or property by reason of anything forbidden in the anti-trust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without re-

spect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. Oct. 15, 1914, c. 323, § 4, 38 Stat. 731." (15 U.S.C. 1951 Ed., § 15.)

INTERNAL REVENUE CODE OF 1954:

"SEC. 61. GROSS INCOME DEFINED.

"(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust."

## QUESTION PRESENTED.

Did respondent's receipt of punitive damages pursuant to Section 4 of the Clayton Act (15 U.S.C. § 15) constitute income under Section 22(a) of the Internal Revenue Code of 1939?

## SUMMARY OF ARGUMENT.

A penalty, however else it may be characterized, is not income within the ordinary contemplation of the term or within the accepted interpretations of Section 22(a). It is not a gain derived from capital or labor, the familiar touchstone of statutory income.

The Government, in asking that Section 22(a) be construed to apply to any gain, is urging the Court to accomplish by a changed judicial interpretation what Congress has never done. Congress has not chosen to tax penalties specifically, nor to define income as every increase in resources, despite a long history of opportunity to do so if it wished, and despite the essentially legislative nature of the problem. In particular, the revised phraseology of Section 22(a) in the new 1954 Code both eliminates the verbal basis for the Government's argument and underscores the absence of Congressional support for the Government's interpretation.

# Argument.

## THE PENALTY RECEIVED BY THE TAXPAYER UNDER SECTION 4 OF THE CLAYTON ACT IS NOT TAXABLE UNDER SECTION 22(a) OF THE INTERNAL REVENUE CODE OF 1939.

We fully agree that Congress has the power to tax the receipt of a penalty.

The question is: Has Congress done so?

The answer depends on whether Section 22(a) of the Internal Revenue Code of 1939 is properly construed to include a payment of this character.

Congress has never expressly stated an intention to tax penalties. It did not include the term "penalties" among the items specifically listed in the earliest counterpart of Section 22(a), and it has never added the term to the statute during the more than forty years that the income tax laws have been in effect.

Congressional silence may not always have significance. But here there has been inaction over a period of many years; there have been occasion and opportunity for Congress to act if it wished to do so; and the problem involves essentially legislative considerations.

We think that in these circumstances the Congressional silence is impressive evidence against the Government's position which would impose the tax through a new judicial construction of Section 22(a)—a construction that is based on particular words which no longer even appear in the 1954 codification of the law, and that would extend the meaning of Section 22(a) beyond all prior interpretations.

**1. Opportunities for Congressional Action.**

These penalties are not some new or novel development which Congress could not have specifically foreseen. The antitrust laws had been on the books for many years when the first modern income tax law was adopted in 1913.[1] They were obviously known to Congress, both then and since.

In 1917 this Court put Congress and the executive branch on specific notice that the income tax statute did not reach every realized gain. *Gould v. Gould,* 245 U.S. 151 (1917). The Court held there that the receipt of alimony, absent an express reference, was not included in the generalized language of Section II, B of the 1913 Act.[2] A year later the Court reminded Congress and the executive branch that "all receipts—everything that comes in—" are not "income within the proper definition of the term 'gross income' . . ." *Southern Pacific Co. v. Loew,* 247 U.S. 330, 335 (1918).

Then, within the next two years, the Court construed the general language of Section II, B of the 1913 Act as the expression of an intention to tax whatever constituted "income" within the meaning of the Sixteenth Amendment, and in *Eisner v. Macomber,* 252 U.S. 189, 206 (1920), the Court restated its prior definition of what was meant by income—the familiar "gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets." Distinguish or explain the statement as the Government may, it did become common parlance in tax practice and administration, and it was reiterated again and again in judicial decision.

Thus Congress early had before it pronouncements by this Court marking both limitations and content for Section 22(a). In view of those limitations the Court of Ap-

1. Tariff Act of Oct. 3, 1913, 38 Stat. 114, 166, c. 16.

2. Section II, B was the counterpart of Section 22(a) of the Internal Revenue Code of 1939, 26 U.S.C. Sec. 22(a).

peals for the Third Circuit in 1935 held that a penalty came neither within the constitutional nor the statutory concept of income. *Central Railroad Co. of New Jersey v. Commissioner,* 79 F. 2d 697 (C.A. 3rd, 1935). Five years later the Board of Tax Appeals held expressly that punitive damages did not come within the meaning of Section 22(a). *Highland Farms Corp. v. Commissioner,* 42 B.T.A. 1314 (1940).

Over the twenty-year period since the *Central Railroad* decision we have witnessed a great volume of litigation involving the enforcement of the anti-trust laws. They have also been the subject of much political debate. During the same period of time there have been almost annual revisions of the income tax laws, but no move was made to provide for the taxation of penalties. The Bureau of Internal Revenue had noted its non-acquiescence in the *Highland Farms* case, but it did not appeal and the Treasury Department proposed no legislative action despite the weight which this Court had held must attend the decisions of the Board of Tax Appeals.[3]

Finally, less than six months ago Congress adopted the Internal Revenue Code of 1954,[4] the most comprehensive revision of the Internal Revenue laws at least since 1913.[5] This occurred after the unanimous decision of the court below sitting *en banc* in the instant case, and before the grant of certiorari. Although Section 61(a) (the successor to Section 22(a)) lists fifteen specific items within the definition of "gross income," Congress has yet to include penalties.

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3. See, e.g., *Dobson v. Comm'r,* 320 U.S. 489 (1943), reh. den. 321 U.S. 231 (1944); *Comm'r. v. Sunnen,* 333 U.S. 591, 607-608 (1948). See also *Arrowsmith v. Comm'r.,* 344 U.S. 6, 12 (1952) (dissenting opinion), reh. den. 344 U.S. 900 (1952).

4. H.R. 8300, c. 736, P.L. 591, 68 A. Stat., Approved August 16, 1954.

5. See H. Rep. No. 1337, p. 1, 83d Congress, 2d Sess.

**2. The Legislative Nature of the Problem.**

As we have stated, the significance of the fact that Congress has never specifically included penalties among the Section 22(a) items is emphasized by the distinctly legislative character of the problem. Whether, how, or to what extent penalties should be taxed involves questions which, we submit, can be effectively explored and answered only through the legislative process.

For example, what would the effect be on the administration of the anti-trust laws? The treble damage provisions obviously evolved from considerations affecting the enforcement of these statutes. Congress has required a monopolist or conspirator who has injured another party to make that party whole, and then, as a penalty, he must also give that party an amount of capital equal to twice the actual damages.[6] Will that policy be served, defeated or impaired if, through the imposition of a tax, a portion of the payment must be turned over to the Government? If there is a tax, should it be at the ordinary rates or at capital gain rates?[7] If the payment should be taxed as ordinary income, should it be treated as having been received over a number of years—the years of the conspiracy for example—in order to alleviate the effect of a receipt in a single year?[8]

Considerations such as these affect both the public and the individual taxpayer. They cannot be resolved effec-

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6. See Clayton Act, Section 4, 38 Stat. 731, 15 U.S.C. Sec. 15. It provides that the injured plaintiff "shall recover threefold the damages by him sustained, . . . ."

7. If it is taxable to the recipient and is not deductible by the payor, as the Government has claimed, the Government would collect a sum equal to 76% of any penalty under the 38% tax rate in effect in 1948. Under the current rates of 52% the Government would recover 104%.

8. Cf. Section 107 of the 1939 Code which provides that lump sum compensation for services, artistic compositions, copyrights, etc., produced over a period of 36 months or more, is to be taxed as if received during the period in which the work was done. See, to the same effect, Internal Revenue Code of 1954, Section 1301, et seq.

tively through litigation because of the limitations inherent in the judicial process. Sound Government and fair Government require that they be analyzed and resolved through normal legislative procedures before a tax is imposed, especially where the receipt in question itself results from a legislative mandate.

The history of the taxation of alimony payments provides an illustration. As we have pointed out, in 1917 this Court held that alimony was not "income" within the meaning of the then counterpart of Section 22(a). In 1942, however, Congress re-examined the situation. The result was the addition of new provisions to the Code providing that alimony would be taxed, but only in certain prescribed situations, subject to specified limitations.[9] Except to the limited extent that Congress has specifically taxed alimony, the *Gould* decision is operative. The situation is directly analogous to the case at bar because alimony, like a penalty, is not derived from capital or labor, and therefore is not "income" within the ordinary comprehension of the term.

The Treasury Department, if it thought penalties should be taxed (for reasons of symmetry or otherwise), has had every opportunity to present the issue to the legislative branch for its consideration. Not only has Congress failed to consider the matter on its own initiative, but also, to the best of our knowledge, the Treasury Department has never asked it to do so. It has chosen instead to ask the courts to accomplish that result by a new, broadened interpretation of the general language of Section 22(a).

### 3. The Government's Argument.

The Government bottoms its case on the proposition that Section 22(a) should be construed to include "all gains received by the taxpayer (not including return of capital)" (*Pet. Br.*, p. 15). It ascribes this meaning to the words "gains, or profits and income derived from any source

9. Internal Revenue Code of 1939, Sec. 22(k); cf. Internal Revenue Code of 1954, Sec. 71.

whatever" contained at the end of the section. It argues that by use of the word "gains," Section 22(a) reaches not merely "income" within the normal meaning of that term, but also any type of increase in net worth which is *not* included within the meaning of the term "income."[10]

Section 22(a) is a strange mixture of specification and generality. It deals specifically with "gains, profits and income" derived (1) from personal service; (2) from businesses of all sorts; and (3) from the investment of capital. This enumeration is then followed by the tail-end reference to "gains or profits and income derived from any source whatever."

The meaning of Section 22(a) is not to be found in verbal or grammatical niceties. Rather, the section has been accepted as an attempt to describe in the statute the general understanding of what is "income." Separate content has not been given to the three words, "gains," "profits," and "income." Necessarily the concluding phrase is no more than a generalized reference to the content supplied the term "income" by the enumeration of items which precede it.

All of this finds expression in the so-called *Macomber* definition of "income." Well before that decision the Court had defined income as "the gain derived from capital, labor or from both combined."[11] That definition carries through to the modern income tax laws an understanding of income, as the term was used in income tax statutes prior to 1913, in

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10. In the court below the Government's argument would have brought *all receipts* within Section 22(a). Because it was pointed out that this definition would encompass even a return of capital, the Government now has qualified its position to include all receipts *except* those constituting a return of capital.

11. The Court employed this definition in its interpretation of "income," as that term was used in the Corporation Excise Tax Act of August 5, 1909, c. 6, sec. 38, 36 Stat. 11, 112. *Stratton's Independence v. Howbert*, 231 U.S. 399, 415 (1913). Later, interpreting the same act, the Court reiterated that definition of income. *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179 (1918).

the Amendment itself, and in the acts adopted after the Amendment.[12] *Eisner v. Macomber* simply noted the inclusion in the definition of "profit gained through a sale or conversion of capital assets." As the Court said in *Merchants Loan and Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1921), ". . . this Court . . . has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the terms which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution . . . [and] we continue entirely satisfied with that definition . . ." It is clear, as the court below held, that penalties do not come within it.

The phraseology of Section 22(a) itself indicates why the words "gains" and "profits" were used together with the word "income." One normally speaks of "income" from personal service or from property. On the other hand, if property is sold it is customary to speak of the "profit" or the "gain" on the transaction, rather than the "income" from it. The words were apparently intended for facility of expression, but in fact they are entirely repetitious.

The new Internal Revenue Code of 1954 shows that the Government's argument reaches far beyond the Congressional understanding of the scope of Section 22(a). As we have noted, Section 22(a) has been replaced by Section 61(a).[13] The report of the House Ways and Means Committee states as follows:

> "This section corresponds to section 22 (a) of the 1939 Code. While the language in existing section 22 (a) has been simplified, the all-inclusive nature of statutory gross income has not been affected thereby. Section 61 (a) is as broad in scope as section 22 (a).

12. In *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918), the Court said: "Certainly the term 'income' has no broader meaning in the 1913 Act than in that of 1909." See also *Merchant's Loan and Trust Co. v. Smietanka*, 255 U.S. 509, 518-519 (1921).

13. See *supra*, p. 2 where Section 61(a) has been set out *in extenso*.

> "Section 61 (a) provides that gross income includes 'all income from whatever source derived.' This definition is based upon the 16th Amendment and the word 'income' is used in its constitutional sense."[14]

The report of the Senate Finance Committee is the same, with the further statement:

> "It is not intended to change the content of income that obtains under Section 22 (a)."[15]

Section 61(a) has *not* defined income to mean all realized gain. It could have done so just that simply if this is what Congress understood Section 22(a) to mean. On the contrary, it *eliminated* those words in Section 22(a) upon which the Government has based its case, and yet intended no change in substance. First, instead of the awkward reference to "gains or profits and income," it provides that "gross income shall mean all income from whatever source derived (including but not limited to) the following items . . ."—thus using only the word "income" as a general term. Second, the specific items listed include "gains derived from dealings in property" (Subsection (3)), and *at no other place* is the word "gains" used.

Thus, the entire verbal basis for the Government's position in this case is no longer to be found in the present counterpart of Section 22(a). Since the reports of both the House Ways and Means Committee and the Senate Finance Committee state that no change in the content of Section 22(a) was intended, the inference is clear that Congress regarded the words "gains" and "profits" in Section 22(a) as adding nothing to its overall meaning.

### 4. The Judicial Decisions.

We disagree with the Government's contention that this Court has held gains subject to tax which do not come

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14. H. Rep. 1337, p. A 18, 83d Cong., 2d Sess.
15. Sen. Rep. 1622, p. 168, 83d Cong., 2d Sess.

within the *Eisner v. Macomber* definition. We think that every case cited deals with a situation where a taxpayer had increased his wealth either through his own activity (labor) or through the use or disposition of property (capital).

In the *Kirby Lumber Company* case the taxpayer had borrowed money, evidencing the debt by its bonds. Later it bought in the bonds at a discount. The Court held merely that as a result of these dealings in bonds the taxpayer had made a profit which was income. *United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931). *Commissioner v. Jacobson*, 336 U.S. 28 (1949) was decided on the same basis—wholly consistent with the *Macomber* definition which requires the use of capital (here the borrowed money and bonds) or labor as the source of taxable gain.

In the *Bruun* case, the owner of leased real estate on which the lessee had erected improvements was held to have realized gain equivalent to the value of the improvements, upon termination of the lease resulting from the lessee's default. Here clearly was a gain derived from use of the taxpayer's property. In fact, the only issue in the case was whether there could be a *realization* prior to severance or disposition of the improvements, not whether there was income. *Helvering v. Bruun*, 309 U.S. 461 (1940).

In the *Rutkin* case the taxpayer was taxed on money obtained through extortion. The money had come to the taxpayer as a result of his efforts and business dealings, although they were illegal, and the only question was whether illegality affected taxability. *Rutkin v. United States*, 343 U.S. 130 (1952).

In the *Robertson* case the taxpayer had composed the winning symphony in a prize contest; the only question was whether the prize was a *quid pro quo* for services rendered or a gift. The court found that it was the former, and therefore taxable. *Robertson v. United States*, 343 U.S. 711 (1952).

In *Irwin v. Gavit*, 268 U.S. 161 (1925), the question was whether the income from bequeathed property was exempt from tax under the statutory exemption for bequests. There was no question but that the income from the property as such was within Section 22(a).

In *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88 (1936), lost profits had been recovered in settlement of a patent infringement suit. The recovery was taxed because it had the same character as the funds which it replaced—*just as there has been no question in the instant case as to the taxability of the taxpayer's recovery of damages for its lost profits.*

*Dobson v. Commissioner*, 320 U.S. 489 (1943), reh. den. 321 U.S. 231 (1944) involved a reaffirmation of the tax benefit rule. The recoveries which were taxed had their foundation in a capital transaction, and it makes no difference whether the capital is regarded as the securities which the taxpayer had sold or the income tax payments saved as a result of the loss deductions—capital in either event.

Section 22(a), as the Court has often stated, is broad in its scope and is intended to tax *income* comprehensively. However, the Court has never said, nor held, that Section 22(a) includes as income an item of gain which is not derived from capital or from labor.[16]

The Government has suggested that since the penalty was obtained as a result of litigation, it could be said to be derived from labor or capital. This argument fails to take into account the fact that the payment of the penalty derives entirely from an Act of Congress designed to punish wrongdoers. Litigation is but the means by which it can be collected.

Whenever a recovery in litigation is involved, the question always to be asked in determining taxability is, "In

16. On the contrary, the *Macomber* definition was reiterated by this Court only a few years ago in *Commissioner v. Culbertson*, 337 U.S. 733, 740 (1949).

lieu of what were the damages awarded?"[17] If the donee of a promissory note, enforceable only because it is under seal, is required to bring suit against the maker, payment of the judgment is nevertheless a gift. If a legatee under a will must prosecute his claim against the executor of the decedent's estate for recovery of his bequest, the award of the Probate Court is nevertheless a bequest.

If the anti-trust defendants had admitted their wrong, computed and volunteered to taxpayer its actual damages, and then trebled that sum in order to arrive at the statutory penalty, the latter would not be a receipt derived from capital or labor, but solely from a congressional mandate. The mere fact that the tapayer had to bring suit to recover the penal award cannot translate the source into capital or labor.

In *Mathey v. Commissioner*, 177 F. 2d 259 (C.A. 1st, 1949), aff'g. 10 T.C. 1099 (1948), cert. den. 339 U.S. 943 (1950), the inquiry of the courts was directed to the question whether the award was compensatory or penal. On a finding, based on the taxpayer's own admissions in the patent infringement suit, that the award was compensatory in its entirety and not penal, the entire award was taxed. Implicit in the decision of both the Tax Court and the First Circuit was the view that a penalty is not a gain from capital or labor, and therefore not income in the accepted sense.[18]

Again in *H. Liebes & Co. v. Commissioner*, 90 F. 2d 932 (C.A. 9th, 1937), a recovery of lost profits was taxed. It

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17. *Raytheon Production Corp. v. Commissioner*, 144 F. 2d 110 (C.A. 1st, 1944), cert. denied 323 U.S. 779 (1944).

18. The patent infringement statutes (Rev. Stat., Sec. 4919, 1946 ed. 35 U.S.C. 1946 ed., Sec. 67; Rev. Stat. Sec. 4921, 1946 ed. 35 U.S.C. 1946 ed., Sec. 70) are not penal. They merely authorize a court, in order more accurately to determine the *actual* damages sustained, to increase the *provable* loss "according to the circumstances of the case, not exceeding three times the amount of such a verdict . . ." See the opinion of the Court of Appeals in the *Mathey* case at p. 264 and the opinion of the Tax Court at p. 1104.

was clear from the Court's opinion that it was not including a penalty within its concept of income.[19]

The decision of the Court of Appeals for the Third Circuit in *Central Railroad Co. v. New Jersey* may be subject to criticism with respect to the *factual conclusion* that the taxpayer had recovered a penalty. It is only on this ground that the earlier decisions of the Second Circuit in *Sterling v. Commissioner*, 93 F. 2d 304 (1937), cert. den. 303 U.S. 663 (1938), and *Lyeth v. Hoey*, 96 F. 2d 141 (1938), rev'd. on other grounds 305 U.S. 188 (1938) criticized the *Central Railroad* decision. Similarly *Arcadia Refining Co. v. Commissioner*, 118 F. 2d 1010 (C.A. 5th, 1941) differs from the *Central Railroad* decision only because of a contrary *factual* interpretation. But nothing in the court's opinion leads to the conclusion that a true penalty is to be treated as income.

Except for the Seventh Circuit's decision in the *Obear-Nester* case (*Commissioner v. Obear-Nester Glass Co.*, — F. 2d—(C.A. 7th, Nov. 15, 1954), Pet. for cert. pending, Oct. Term, 1954, No. 478, no court has permitted the Commissioner to tax a gain not derived from capital or labor. The courts which have considered the question have directed their inquiry to *whether* a receipt is a penalty. When this court was squarely presented with a gain which was not derived from capital or labor, it held that the gain was not within the scope of Section 22(a) (*Gould v. Gould, supra*).

The Court below recognized that punitive damages or penalties are *sui generis*, not easily characterized (R. 36) They have no ready synonym. But whether the receipt o. the penalty is analogized to a gift from the sovereign or a

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19. The Court indicated that a recovery, to be taxable, must be from capital or labor. It distinguished the *Central Railroad* decision by noting (pp. 936-937) that in that case "a recovery which was neither profits nor for an injury to capital was held not taxable. Such is not the case here."

forced transfer of property or a subsidy,[20] it is clear that a penalty is not derived from anything that the taxpayer or its capital has produced or would have produced if it had not been prevented by the anti-trust defendants. On the contrary, it is a payment exacted by law to penalize a law-breaker for his infraction.[21]

### 5. The "Insider Profits" Case.

In the "insider profits" case which is also before the Court the taxpayer has attempted to bring the profits which it has recovered within the concept of a penalty. *General American Investors Company v. Commissioner*, (Oct. Term, 1954, No. 114). If indeed the award under Section 16(b) is viewed primarily as a penalty imposed upon the insider, and if, therefore, the Court concludes that the recovery is not the result of a devotion of capital or labor, then the insider profits are not taxable.

On the other hand, the recovery of insider profits may well be analogized to the recovery of the lost profits which the instant taxpayer received and reported, or which the taxpayer in the *Safety Car Heating & Lighting Co.* case had recovered. If the court finds that Section 16(b) does not provide for punitive damages but rather is intended to restore what the Congress has presumed to be the corporation's profits, then of course the recovery should be taxed.

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20. See, e.g., *Edwards v. Cuba R. R. Co.*, 268 U.S. 628 (1925).

21. The treble damage aspect of the Clayton Act recovery has been recognized consistently as punitive and deterrent in nature and purpose. See Mr. Justice Black in *United States v. Hess*, 317 U.S. 537, 550 (1943) and Mr. Justice Frankfurter's concurring opinion in the same case (p. 556). See also *Bigelow v. RKO Radio Pictures*, 150 F. 2d 877 (C.A. 7th, 1945), rev'd on other grounds, 327 U.S. 251 (1946); *Clark Oil Company v. Phillips Petroleum Company*, 148 F. 2d 580, 582 (C.A. 8th, 1945), cert. den. 326 U.S. 734 (1945); Bills and Debates in Congress Relating to Trusts, 1903, Sen. Doc. #147, 57th Cong., 2d Sess.; The History of Bills and Resolutions, 51 Cong. Res. Index 160, H.R. 15657, 63d Cong., 2d Sess.

The language of Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. 1952 ed. § 78p(b)) expresses a legislative policy which regards an insider who has access to information belonging to the corporation as having traded on that information, and therefore, any profits which he realizes are recoverable by the corporation. The section provides that in order to prevent "the unfair use of information which may have been obtained . . . [by an insider] . . . by reason of his relationship to the issuer, any profit realized . . . shall inure to and be recoverable by the issuer . . ." The profits are presumed to have been derived from the corporation's information and so from its capital. Thus within the *Macomber* definition of income the profits would be taxable to the corporation.

Section 4 of the Clayton Act bears no comparison to Section 16(b) of the Securities Exchange Act of 1934. The latter is intended to enable the corporation to recover what may be derived from its capital and no more. The Clayton Act, however, gives the injured party his lost profits on which he must pay his tax, and, in addition, a penalty imposed on the monopolist as a punishment or deterrent.

## CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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Philadelphia 2, Pennsylvania,
*Attorneys for Respondent, William Goldman Theatres, Inc.*

January, 1955.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954.

**No. 199**

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*vs.*

GLENSHAW GLASS CO. AND WILLIAM GOLDMAN THEATRES, INC.,
*Respondents.*

ON CERTIORARI FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

## MOTION FOR LEAVE TO FILE A BRIEF ON BEHALF OF DEAN MILK COMPANY AS AMICUS CURIAE.

THOMAS C. MCCONNELL,
*Attorney for Dean Milk Company, a corporation.*

THE BUNTHORP-WARREN PRINTING COMPANY, CHICAGO

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954.

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**No. 199.**

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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*vs.*

GLENSHAW GLASS CO. AND WILLIAM GOLDMAN THEATRES, INC.,
*Respondents.*

---

ON CERTIORARI FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

---

## MOTION FOR LEAVE TO FILE A BRIEF ON BEHALF OF DEAN MILK COMPANY AS AMICUS CURIAE.

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*To the Chief Justice and Associate Justices of the Supreme Court of the United States:*

Now comes DEAN MILK COMPANY, a corporation, by Thomas C. McConnell, its attorney, and asks leave of this Court to file instanter a brief as *amicus curiae* in the instant case, and for cause shows:

This proceeding originated upon petitions for redetermination of deficiencies determined by the Commissioner of Internal Revenue against *Glenshaw Glass Co.* and *William*

*Goldman Theatres, Inc.*, on account of the recovery of punitive damages or the two-thirds penalty part of a Clayton Act recovery.

The Commissioner appealed two decisions of the Tax Court of the United States, reported in 18 T. C. 860 and 19 T. C. 637, in favor of these two taxpayers, and the Court of Appeals for the Third Circuit affirmed the Tax Court decisions in an opinion reported in 211 F. 2d 928. Certiorari was granted by this Court on October 14, 1954, and the case has been placed on the summary docket.

Movant corporation received by settlement the sum of $1,225,000 in satisfaction of its claims under the Sherman Act for loss of profits and treble damages occasioned by virtue of an illegal monopoly and conspiracy in the milk business in the City of Chicago. The case is docketed in the United States District Court for the Northern District of Illinois, Eastern Division, as "*Dean Milk Company* v. *American Processing and Sales Company, Inc., a corporation, et al.,*" No. 49 C 1159.

Movant corporation has been advised by the Commissioner of Internal Revenue that whether or not two-thirds of the sum it received in settlement of the aforesaid action is taxable depends upon the decision of this Court in the instant case.

While the present state of the tax law is adequately briefed by the litigants in the present case, we understand that important questions of public policy involved in the effect of a decision declaring the penalty provisions of the anti-monopoly laws taxable income have not been brought to the attention of the Court.

Since the enforcement of the anti-trust laws has been encouraged by the Congress by the grant of treble damage judgments, to construe the tax laws in a way to include such punitive penalty as taxable income is to destroy any

incentive to private litigants to engage in treble damage litigation and to thwart the express intention of the Congress to provide effective anti-trust law enforcement through the adjunct of private suits.

As pointed out in the accompanying brief, the private treble damage action is an important adjunct to the enforcement of the anti-trust laws by the Department of Justice. A decision in the instant case which would permit the taxing away of the penalty provided by the statutes would to that extent render nugatory the treble damage incentive created by the Congress for the enforcement of the anti-trust laws.

WHEREFORE, DEAN MILK COMPANY asks leave to file instanter the accompanying brief as *amicus curiae*.

Respectfully submitted,

DEAN MILK COMPANY, *a corporation*.
By THOMAS C. MCCONNELL,
*Its Attorney*.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954.

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**No. 199.**

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COMMISSIONER OF INTERNAL REVENUE,

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*Respondents.*

---

ON CERTIORARI FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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## MEMORANDUM OF DEAN MILK COMPANY AS AMICUS CURIAE.

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This is a suit originated upon petitions for redetermination of deficiencies determined by the Commissioner of Internal Revenue against *Glenshaw Glass Co.* and *William Goldman Theatres, Inc.*, on account of the recovery of punitive damages or the two-thirds penalty part of a Clayton Act recovery.

The contention of the Commissioner of Internal Revenue in the instant case raises squarely the question of a conflict between two Acts of the Congress and between two law enforcement agencies of the government in the event

that the tax laws are construed to permit the taxing of penalties and punitive damages created by the Congress as a means of effective anti-monopoly enforcement.

In *United States* v. *Bausch & Lomb Co.*, 321 U. S. 707, 728; 88 L. Ed. 1024, 1038, this Court, after referring to the statutory provisions authorizing persons injured by violation of the anti-trust laws to bring suit for injunctive relief and to sue for threefold damages, said:

> "Congress has been liberal in enacting remedies to enforce the anti-monopoly statutes."

It must be assumed that the Congress believed that there was need for each of the remedies which it provided. Any decision by this Court which substantially militates against the effectiveness of one of the remedies is of serious public consequence.

In an *amicus curiae* brief filed by the Solicitor General of the United States in *Bigelow, et al.* v. *RKO Radio Pictures, Inc., et al.*, 327 U. S. 251; 90 L. Ed. 652, heard by this Court, it was stated:

> "While the Government endeavors to enforce vigorously the remedies granted to it, triple-damage suits by injured private parties are an important supplementary aid in bringing about obedience to the commands of the statute."

In *Maltz* v. *Sax*, 134 F. 2d 2, cert. denied, 319 U. S. 772, the Court of Appeals for the Seventh Circuit said at page 4:

> "* * * This grant to persons damaged—a cause of action for treble damages—was for the purpose of multiplying the agencies which would help enforce the Act and therefore make it more effective.
>
> "All of the provisions and purposes of this Act must be construed together, with its main purpose that of protecting the public against restraints of commerce, clearly its major object."

Obviously, a construction of the taxing statutes which renders taxable and thus in practical effect nugatory the

treble damage provisions of the anti-trust laws discourages the institution and prosecution of treble damage suits, and thus militates against the legislative purpose of the Congress in protecting the public against restraints of commerce.

Under the best of circumstances the prosecution of a treble damage suit is heavily weighted in favor of the defendants. The loss of such a suit may result in retribution by the defendants and in revengeful tactics which in practical effect may put the complaining party out of business.

The inclusion of treble damages in an award for injuries sustained by reason of a violation of the Act, as a practical matter and as the Congress well knew, is a necessary inducement for a private litigant to undertake such litigation. Further, the practical difficulty involved in making the meticulous proof of damages required by the courts justifies the inclusion of treble damages in the award. See decisions of the United States Court of Appeals for the Seventh Circuit in *Bigelow, et al.* v. *RKO Radio Pictures, Inc., et al.*, 150 F. 2d 877, and in *Milwaukee Towne Corporation* v. *Loew's Incorporated, et al.*, 190 F. 2d 561.

Most treble damage suits are brought to recover profits lost during a period of some years duration—usually the statutory period for the limitation of actions. Under present income tax regulations such recovered profits are taxable in the year of receipt, and thus under graduated rates are taxed in a much higher amount than if the business had not been illegally interfered with and the income had been received in the years for which damages are recovered. The present treble damage provisions and the present construction of the Courts rendering them nontaxable to some extent remedies this inequity. To now change the law and to tax all the recovery, including the treble damage portion, would leave the successful litigant,

after a prolonged and arduous litigation, with nothing but a Pyrrhic victory. Nor will the revenue be benefited ultimately because such a change in the tax law will most assuredly discourage such litigation altogether. No private litigant is going to make the tremendous investment in time, money and energy necessary to litigate a treble damage action through the courts merely for the purpose of paying the recovery to the Government. The net result will be not only no treble damages to tax but no compensatory damages as well on which to levy a tax.

On the appeal below (211 F. 2d 928, 933) the Court said:

> "* * * Punitive damages seem to be *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear that they do not fall within the definition of Eisner *vs.* Macomber * * *."

This Court has refused to overturn the definition of taxable income set forth in *Eisner* v. *Macomber*, 252 U. S. 189; 64 L. ed. 521; 40 S. Ct. 189.

In *Helvering* v. *Griffiths*, 318 U. S. 371, 401; 87 L. Ed. 843, 863, this Court said:

> "The Court differs, however, from other branches of the Government in its ability to extricate itself from error. It can reconsider a matter only when it is again properly brought before it in a case or controversy; and if the case requires, as a tax case does, a statutory basis for a case, *the new case must have sufficient statutory support.*" (Italics ours.)

In the instant case, the present state of the law holding punitive damages not subject to taxation has the support of the decisions of the Tax Court and of the Court of Appeals for the Third Circuit. The Congress has just recodified the tax laws and nowhere in such re-codification

is there any statement that punitive damages are taxable as income. Certainly if the Congress held a different view than that stated by the courts it would have said so. Certainly to read such an interpretation into the revenue laws is to thwart completely the enforcement of the anti-trust laws through the adjunct of private litigation.

In the instant case the Congress has not seen fit to change the definition of income set forth in *Eisner* v. *Macomber* or to specifically tax punitive damages or penalties although the tax decisions have long exempted them.

We submit that on grounds of well-defined public policy this Court should not now rewrite the definition of taxable income to include penalties where the practical effect thereof would be to render of no avail an important adjunct to the enforcement of the anti-monopoly statutes provided by the Congress.

WHEREFORE, we most respectfully submit that the decision of the Court of Appeals for the Third Circuit in the instant case should be affirmed.

Respectfully submitted,

THOMAS C. MCCONNELL,
*Attorney for Dean Milk Company, a corporation.*

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IN THE

# Supreme Court of the United States

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COMMISSIONER OF INTERNAL REVENUE,
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*vs.*

WILLIAM GOLDMAN THEATRES, INC.,
*Respondent,*

## RESPONDENTS' PETITION FOR REHEARING.

MAX SWIREN,
SIDNEY B. GAMBILL,
JOSEPH D. BLOCK,
*Attorneys for Glenshaw Glass Company.*

SAMUEL H. LEVY,
BERNARD WOLFMAN,
*Attorneys for William Goldman Theatres, Inc.*

The Scheffer Press, Inc.—ANdover 3-6850

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

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**No. 199**

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COMMISSIONER OF INTERNAL REVENUE,
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COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*vs.*

WILLIAM GOLDMAN THEATRES, INC.,
*Respondent.*

---

## RESPONDENTS' PETITION FOR REHEARING.

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Respondents, Glenshaw Glass Company and William Goldman Theatres, Inc., respectfully petition for a rehearing of the decision and judgment of this Court entered March 28, 1955 reversing the judgment of the United States Court of Appeals for the Third Circuit. The grounds urged by respondents in support of this petition are as follows:

## I.

The Court's decision is predicated upon the broad proposition that Section 22(a) of the Internal Revenue Code of 1939 constitutes "a clear legislative attempt to bring the taxing power to bear upon all receipts constitutionally taxable." (p. 7) Prior decisions of this Court, not mentioned in the instant opinion, do not warrant this construction of the statute.

In *Gould* v. *Gould,* 245 U.S. 151 (1917), it was held that periodic alimony payments did not fall within the statutory definition of income. However, the Congress subsequently amended the statute for the purpose of expressly imposing a tax on such payments and the constitutionality of such treatment has been upheld by the lower courts, with certiorari having been consistently denied by this Court.[1]

The subsidy payments involved in *Edwards* v. *Cuba Railroad Co.,* 268 U.S. 628 (1925), were neither a return of capital nor specifically exempted by statute. Nevertheless, this Court held that they were not subject to tax. Although the payments were intended and used for capital purposes, it cannot be gainsaid that they provided the recipient with a gain "derived from any source whatever." The fact that payments may be earmarked for capital requirements is hardly a realistic distinction since the net effect of such a transaction is the release of other funds for general income purposes.

The continuing validity of the *Cuba Railroad* decision has been recognized as recently as 1950 in *Brown Shoe*

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[1] Sec. 22(k), Internal Revenue Code of 1939; **Mahana v. United States,** 88 F. Supp. 285 (Ct. Cl. 1950), cert. denied 339 U.S. 978 (1950), rehearing denied 340 U.S. 847; **Fairbanks v. Commissioner,** 191 F. 2d 680 (9th Cir. 1951), cert. denied 343 U.S. 915 (1952).

*Co.* v. *Commissioner,* 339 U.S. 583. In that case community contributions were made to the taxpayer to induce the location of industrial plants. The Tax Court expressly said that "the petitioner did not realize taxable income as a result of the transfers." Upon review this Court noted, without expressing disapproval, that the receipts had not been taxed as income.[2]

Similarly, in *United States* v. *Supplee-Biddle Co.,* 265 U.S. 189 (1924), the Court declined to subject insurance proceeds to the income tax even though there was considerable doubt that the statutory exemption extended to the receipts there involved. The Court assumed that there were no constitutional barriers to the imposition of the tax, but insisted that the legislative purpose to tax such payments be clearly expressed. The statutory definition of gross income was denied the pervasive sweep now accorded to it for the first time.

The prior decisions of this Court thus disclose that a variety of gains have been held to fall beyond the reach of the taxing statute even though there can be no doubt that they are constitutionally taxable. Adherence to these decisions requires an affirmance of the judgment of the Court of Appeals for the Third Circuit in this proceeding.

## II.

The established concept of income, as expressed in *Eisner* v. *Macomber,* 252 U.S. 189, 207 (1920), is dismissed upon the ground that the decision in that case involved only the question of realization of income. The long line of decisions of this Court, cited in our principal briefs, which have utilized that concept in the ascertainment of what constitutes income, is thus ignored. No weight is

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[2] 10 T.C. 291, 292 (1948); 339 U.S. at 587n.

accorded to the recognition of the *Eisner* v. *Macomber* concept in *Commissioner* v. *Culbertson,* 337 U.S. 733 (1939).

Since the inquiry in this case is one of ascertaining legislative intent, it is unfair to the respondents to disregard a series of decisions which extend over a period of many years and which have consistently characterized the essential attributes of income as gain derived from capital, from labor, or from both combined. The repeated reenactment of the statutory definition of gross income, in the light of these decisions, may be soundly said to have engrafted the judicial concept into the meaning of the statute.

## III.

The legislative history of the Internal Revenue Code of 1954 convincingly demonstrates recognition by the Congress that punitive damages did not constitute taxable income under the 1939 Code. The joint recommendation of the Staff of the Joint Committee on Internal Revenue Taxation and the Treasury Department to insert a provision for the exclusion of punitive damages was rejected by the House Ways and Means Committee because some of the members thought that the question should be given further study before a decision was made *either to codify or to change existing law.* Moreover, the Committee did not enumerate punitive damages as an item of gross income *in order to avoid the implication that Congress thereby intended to tax such damages.*[3]

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[3] The above statements were supplied to us by a member of the Staff of the Joint Committee on Internal Revenue Taxation. The information was released with the permission of the present and former Chairmen of the House Ways and Means Committee and the Chief of the Staff of the Joint Committee. See respondents' post-argument memorandum dated March 18, 1955.

The opinion of the Court does not refer to this significant action in the legislative history of the 1954 Code. The fact that the decision of the Tax Court in this very proceeding was called to the attention of the Congress and that no measures were taken to change the rule of the case furnishes persuasive support for respondents' position that as a matter of Congressional understanding and purpose punitive damages are not within the statutory definition of gross income and are not subject to tax.

## IV.

A recovery for libel *per se,* without a showing of actual damage, is nontaxable.[4] There is no fundamental distinction between such a recovery and the punitive damages involved in this case. In addition to its deterrent effect, a punitive damage award is intended to provide the injured party with a measure of recovery sufficient to make him whole and to cover the inevitable impairment of capital which is not susceptible of definite ascertainment and proof. It is upon this same reasoning that personal injury recoveries have consistently been treated as nontaxable by administrative rulings.

There is a clear basis for distinguishing between a recovery of actual damages and the additional amount awarded as punitive damages. The actual damages are received in lieu of ascertainable lost profits and must be treated as such for tax purposes. The punitive portion of the recovery, however, does not represent lost profits but represents a restoration, insofar as it can be accomplished by a monetary payment, of the intangible and

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[4] **C. A. Hawkins v. Commissioner,** 6 B.T.A. 1023 (1927); acquiescence of Commissioner noted, VII-1 Cum. Bull. 14 (1928).

unascertainable loss of good will, reputation and standing that is necessarily experienced by a victimized enterprise.

Wherefore, respondents respectfully pray that a rehearing be granted and that upon such rehearing the judgment of the United States Court of Appeals for the Third Circuit be affirmed.

Respectfully submitted,

MAX SWIREN,
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JOSEPH D. BLOCK,
*Attorneys for*
*Glenshaw Glass Company.*

SAMUEL H. LEVY,
BERNARD WOLFMAN,
*Attorneys for William Goldman*
*Theatres, Inc.*

**Certificate of Counsel.**

The undersigned hereby certifies that the foregoing Petition for Rehearing is presented in good faith and not for delay.

.....

MAX SWIREN.